WARTIME PROBLEMS OF STATE AND LOCAL FINANCE

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FOREWORD

Concentration of attention on the fiscal requirements, problems, and policies of the federal government in its conduct of the war has a tendency to obscure the less spectacular, but nevertheless real, fiscal problems of state and local governments in wartime. The Tax Institute, mindful of the fact that the perpetuation of our state-local system of government demands the maintenance of financial stability particularly in so critical a period, in recent months planned and sponsored a series of regional conferences on the subject of wartime problems of state and local finance and made it the topic of its annual symposium for 1942. The papers in this volume are the product of this timely program.

The problems discussed are those which are of serious present concern to all responsible state and municipal officials and to every thoughtful citizen interested in safeguarding local self-government from becoming a casualty of the war and, at the same time, in having it contribute to the fullest extent to the achievement of victory. The general topics covered disclose the scope and purpose of the symposium to be the marshalling of pertinent facts regarding present and impending fiscal problems and the application of these facts to the formulation of immediate policies and of forward looking plans.

Chapters dealing with the effect of the war on the cost of state and local governments, on their revenues, and on the accentuation of intergovernmental fiscal problems not

only present an abundance of up-to-the-minute factual data useful to administrators, legislators, and citizens in general, but also analyze them in terms of need for clear thinking and prompt action. No one can read these thoughtful contributions without the conviction that the war is creating or intensifying problems which are more than temporary in type, and whose successful solution remains largely to be achieved.

Succeeding chapters recognize the present responsibility for "shaping fiscal policies to aid in postwar adjustment," and stress convincingly the dangers in following policies of fiscal expediency, in failure to make postwar plans, and in neglect of reasonable steps to create reserve financial power for the effectuating of such plans. The specialists who contribute these chapters offer specific suggestions, well worth taking into account in the determination of both policy and program, as to how, in time of war, states and cities can prepare for peace.

At no time do the authors lose sight of the fiscal responsibilities of state and local governments in the winning of the war. A special section of the volume is devoted specifically to consideration of these responsibilities, but the feeling is clear throughout the entire discussion that basic obligations include the maintenance of financial stability, intensification of effort to solve both local and intergovernmental fiscal problems, and the exercise of the utmost foresight in the formulation of fiscal policies and plans.

The Program Committee consisted of William C. Beyer, Director, Philadelphia Bureau of Municipal Research; Dixwell Pierce, Secretary, California State

Board of Equalization; and myself as Chairman; with Harold S. Buttenheim, Editor, *The American City,* Alfred H. Williams, President, Federal Reserve Bank of Philadelphia; and Mabel L. Walker, as ex-officio members.

FREDERICK L. BIRD,
Chairman,
Program Committee

New York
February, 1943

PART ONE

WHAT THE WAR IS DOING TO STATE AND LOCAL COSTS

CHAPTER I

EFFECT OF THE WAR ON COSTS OF STATE GOVERNMENT

A. E. Buck

Institute of Public Administration

Like private business, state government is more or less affected by the inflationary tendencies, restricted trade and commerce, and economic dislocations growing out of war conditions. Marked increases in the cost of living, such as we have already experienced in the present war, intensify the demands of state employees for additional pay and bolster up the costs of food, clothing, and other supplies which the state government must purchase for its institutional wards. While some state services decline in volume or altogether disappear under wartime economy, others are greatly magnified. Public works construction, for example, is ordinarily reduced to a minimum or entirely suspended because of restricted financing, or lack of materials, or both; while, on the other hand, those services supplying aid or sustenance to aged folks, handicapped persons, and mothers and dependent children are of necessity considerably increased. In some sections of the country the huge volume of war industries, defense activities, and the like make additional demands upon the protective and inspectional services of the state government. In the long run the effects of war are likely to increase the total expenditure requirements of state government, and at the same time to decrease its tax resources.

The 1941 Expenditure Picture

With this preliminary statement, let us take a look at the general expenditure picture of state governments, as presented by the United States Census Bureau in its excellent Special Study, No. 20,[1] prepared under the direction of Wylie Kilpatrick and issued in September, 1942. The figures tabulated in this study are for 1941 or for the fiscal years ended in this twelve-month period. They are presented in three ways, namely, gross expenditures from all sources (Table 14), net expenditures from the states' own sources (Table 16), and net expenditures for the states' own purposes (Table 17). Obviously, the last mentioned tabulation showing the net expenditures of state governments for their own purposes or functions is the most significant for our use.

It may be observed before discussing the functional analysis of this tabulation that the total state expenditures from all sources have increased about 117 per cent in nine years. They have mounted from $2,600,000,000 in 1932 to $5,650,000,000 in 1941. This rapid growth assumes added significance when we observe from the same table (Table 22) that the total expenditures of all local governments increased very little—in fact, only 8 per cent—during this same period. It means that during the depression years most of the added costs of government on the state and local levels were attributable to the state governments. Of some three billion dollars increase in state expenditures for the nine-year period, as shown by the 1941 figures, approximately three-quarters of a billion came from federal subsidies and the

[1] Bureau of Census, *Financing Federal, State, and Local Governments: 1941*, State and Local Government Special Study No. 20, September, 1942.

states in turn transferred to local units about one and three-quarters billions as subsidies and shared taxes. This left an actual net expenditure increase for all state functions of about one and one-fourth billions for the nine-year period, or a jump of fully 50 per cent in net state costs, the lion's share of which went to old age benefits, unemployment insurance, welfare, and schools. With this large boost in costs resulting mainly from the depression policies of the federal government, state governments entered the present war period late in 1941. What are going to be the effects of the war on these costs? Some effects are already apparent; others are not difficult to divine.

Referring again to the over-all expenditure picture for 1941, it should be pointed out that the net costs of state governments for their own functions are only about 53 per cent of those of local governments (Table 17). The total volume of state costs is, therefore, the smallest by far of the three levels of government—federal, state, and local. But state costs have shown a decided tendency to increase much more rapidly than local costs, perhaps because state tax systems in the past have provided revenues more readily and more abundantly than local systems.

Debt Service and Current Obligations

Of the $3,900,000,000 expended in 1941 for strictly state purposes, approximately one-half was required for debt service and other current obligations. Some $350,000,000 was paid out for debt service, $120,000,000 of which went for interest alone. Recent figures supplied by the Census Bureau indicate that the state debt service has declined

somewhat during the past year or so, and there is reason to believe that this decline will continue for the duration of the war or until such time as the state governments again start to issuing bonds. Some states have already set aside funds, out of the surplus revenues which they have accumulated during the past few months, for the ultimate retirement of part of their debt (all of the debt in the case of one state). Of course, it is not expected that these surplus revenues will continue to build up in the state treasuries when the full impact of recent federal war taxes is felt, not to mention the effects of constantly tightening conditions of war economy on state revenues. Several factors in connection with state expenditures have contributed lately to the contraction of state debt. Increasing federal restrictions on construction materials have reduced to a minimum the need for bond funds, and have even permitted the revenues formerly allocated to construction to be transferred to debt service. Some state governments have reported that because of the virtual cessation of highway construction, substantial revenues and impounded funds which normally would have been expended for this purpose will be used to retire outstanding highway debt. It may also be noted in this connection that a considerable part of the state bonds issued in recent years were for relief needs. The expansion of war industries has virtually terminated expenditures for the relief of employables, and is reducing the need for assistance to unemployables in a number of states.

More than one and a half billion dollars was paid out by the state governments in 1941 to meet their current obligations other than debt service. This large sum was expended (or transferred to reserves) for old age bene-

fits, child welfare, unemployment insurance, pensions, and certain fixed contributions. These obligations show every evidence, with a few exceptions, of requiring greater expenditures for each successive year. Old age benefits, for example, have mushroomed into a large volume almost overnight. Politicians have vied with benevolent individuals in supporting state laws which in some instances are reported to provide for old age benefits that burden the tax resources of the state. The Census Bureau has listed, as of January, 1942, a total of 2,240,000 persons receiving old age assistance, or an increase of 450,000 over January, 1939. The annual payment to these persons is well over a half billion dollars.

Aid to dependent children, which forms the major portion of child welfare, has also grown by leaps and bounds in recent months. The Census Bureau listed 953,000 dependent children in January, 1942, as against 700,000 in January, 1939. The total cost of aid to these children is now around $150,000,000 a year. The slack in general relief brought about by increased employment due to the war has been more than taken up in many states by additional aid to dependent children and their mothers. This aid may be expected to increase very materially as the war continues.

Effect of War on Payrolls and Supplies

The $2,000,000,000 of state expenditures for 1941 not absorbed by debt service and other current obligations just noted, form what may be regarded as the operating costs of state governments. Viewing these costs from the standpoint of what the money is actually spent for, we find that personal services—salaries, wages, and other

compensations—account for about 40 per cent of the total, or approximately $800,000,000. This amount represents the annual pay of between five hundred and six hundred thousand state officers and employees, not including about a hundred thousand state college and university teachers. It is almost double the total payrolls for state governments in 1929. This enormous increase in state payrolls, it will be observed, came about during a period in which the country was going through one of the worst depressions it has yet experienced. Under the evanescent stimulus of war, which always seems to inflate public payrolls (some worse than others), it is safe to say that state payrolls will be still larger than they are now when this world conflict is over, unless heroic measures are taken in the meantime to keep them down. The political prospects for such measures are, however, none too promising. Recent changes in the administration of some state governments, even where the incoming party was pledged to rigid economy, do not appear in the least to have checked growing state payrolls. Regardless of federal salary and wage ceilings, there are already insistent demands for increased pay in most state services to aid in meeting the rising cost of living. Nor are these demands entirely unjustified. As the cost of living has risen, industrial wages have more or less kept pace with the rising cost, but salary and wage levels in state governments, fixed by the state legislatures at prewar levels, have so far remained constant. The consequence has been, at least in some sections of the country, that many employees have left the state service to take positions outside at higher salaries. As a result, some state governments have found this to be a most appropriate time to conduct a job classification and wage standardization

survey in an effort to eliminate unnecessary jobs and to equalize rates of pay for comparable work throughout the state service. Illinois has almost completed such a survey and will presumably use the findings in fashioning the state budget for the next biennium. A Michigan public expenditure survey recently reported that it is possible to eliminate about two thousand employees with an annual reduction of some two and a half million dollars in the state's payroll.

About 20 per cent of the operating costs of state governments, or some $400,000,000 for 1941, was for supplies of one kind or another, the principal items of which were food, clothing, and household supplies for state wards. The cost of these supplies, in many instances, has already advanced from 20 to 30 per cent over prewar price levels. Because of growing scarcities and increasing federal requirements for the armed forces, it is becoming more and more difficult for state governments to acquire some of the supplies they need. It has even been suggested, in the case of fresh meats, that the states may have to raise their own animals and slaughter them to supply their institutions. Should this become necessary, it is likely that the cost of such products will be increased still more.

Functional Analysis of Operating Costs

Looking at state operating costs from the functional angle, we find that the total of $2,000,000,000 for 1941 was expended approximately as follows: general administration (including the legislature and the judiciary), 10 per cent; highways, 40 per cent; health, hospitals, and corrections, 25 per cent; schools, libraries, and recrea-

tion, 15 per cent; agriculture and conservation, 5 per cent; and police and inspectional services, 5 per cent. All of these items, with the possible exception of highways and general administration, are likely to increase during the war period and to remain up after the war is over.

Highway requirements, amounting to about $850,000,000, are by far the largest of any of the state functions, exclusive of the welfare payments and obligations noted earlier. This amount is, of course, in terms of the expenditures of state governments for the last prewar year. Highway costs, for the duration of the war, will not be as high, since they will be confined largely to maintenance. Little or no construction will be undertaken by the states, except where it is needed to promote the national war effort. Incidentally, there is a feeling in some informed quarters that state highway systems are already overbuilt, and that when the war is over there will not be the same need for new construction as during the past few years. It is not unlikely, too, that the changes in automotive designs after the war may be so revolutionary compared with existing models as to make possible entirely new types of roads built of different materials at perhaps much less cost per mile than is now the case.

State health work is expected to increase during the war period. It is anticipated that new health duties, such as rural sanitation and mental hygiene, will become major problems. The state health departments will have to be prepared to cooperate with army health authorities in preventing the spread of typhoid and other epidemics. Some departments have already found it advisable to start conducting state-wide campaigns looking toward

the immunizing of citizens against smallpox and diphtheria, and are providing without cost the vaccines necessary to carry out this undertaking. State blood plasma banks are being built up in some instances to supply civilian needs in the case of emergencies. State hospitals have added work to take care of the civilian casualties of the war, and after the war is over increased facilities will probably be needed for war-shocked soldiers and sailors. It is barely possible that state correctional institutions will be able to reduce their loads somewhat during the war, but in the postwar days these loads are likely to increase.

Although the school population may be expected to decrease during the war on account of the teen-age draft, the expenditure requirements of schools are not likely to diminish because of the vocational training programs being instituted by the federal government. In addition, the growing shortage of teachers has a tendency to push up salary costs. The agricultural facilities of state governments will need to be kept at something like their present level in order to stimulate the production of food and other farm products required in connection with the war effort. In some instances, the inspectional services temporarily suspended by federal agencies will need to be taken up and carried on by state agricultural departments. Certain conservational and recreational activities of states may be curtailed for the duration of the war. State expenditures for public safety and civilian defense are increasing and will probably continue to grow until the end of the war. Some regulatory and inspectional services may be reduced, notably those in connection with banking.

Need for Reform

The foregoing discussion would seem to justify the arguments of those who think that state governments should continue to spend on prewar levels, and that after the war they should plan to spend even greater amounts from accumulated surpluses or borrowed funds. But such an interpretation overlooks the restrictive effect which others believe that mounting federal taxes may have on state revenues, probably reducing them in a year or so to such proportions as to make it necessary to cut down all state expenditures as far as possible. Even if state revenues do not show a marked decline, they maintain that state expenditures should be cut to a minimum and state taxes correspondingly reduced as a method of promoting, or at least, not hampering, the national war effort. Furthermore, this group is economy-minded enough to believe that considerable savings can be made in state governments, even under war conditions, through administrative and legislative reforms of the kinds which have been adopted by some states during the past twenty-five years. While these reforms, in most cases, have been patchwork affairs, rather than far-reaching and fundamental changes, they have nevertheless produced in several instances better governmental services at less cost by the adoption of such simple expedients as installing modern business methods, and establishing executive responsibility for a departmentalized administration.

But this is not all; most state governments have a long way to go if they are to be even 75 or 80 per cent efficient in the expenditure of funds. Political jobbery is still rampant in more than half of the states. The turnover of state employees, in some instances, is almost

100 per cent when one party or faction succeeds the opposing party or faction in office. The resulting deterioration in the state services is appalling. But patronage alone does not suffice to keep the political machine oiled and going; money is also necessary. To secure this money knockdowns or turn-backs on state contracts for construction, supplies, materials, and equipment are sometimes required of those who do business with the state government. When this procedure does not supply the party chest with ample funds, resort to other means such as 2 per cent clubs and payroll deductions are not an entirely unknown practice. And, incidentally, a great deal more money must be raised through the intricate and undercover processes of splits and pay-offs than ever reaches the party chest for legitimate campaign expenses. If such schemes for sustaining political control could be eliminated or greatly curtailed in those states where they are widely practiced, it would reduce the cost of government tremendously and at the same time improve the quality of state services. Astounding as it may seem, the actual saving to the taxpayers might be as much as 25 per cent of the total annual payroll and supply bill of some state governments. It would be far cheaper from the standpoint of the taxpayers in those states to have the legislature appropriate a tidy sum each biennium for the conduct of political campaigns, and thus make it possible to have qualified state employees kept on a more or less permanent basis while political workers were recruited on the outside and paid from the campaign appropriation.

Aside from these political problems which seem to defy solution because the public in many states is apathetic to, or openly condones, the devious ways of the

spoilsman, there are other fundamental defects in state government which need to be remedied, or at least widely experimented with, in an honest effort to find the proper cures. More vision and daring than we have yet shown are needed in the reform of state government, if we are to make it a useful, effective, and economical part of our postwar governmental system. Many hampering and antiquated state constitutions ought to be completely revised. Incidentally, the Canadian provinces seem to get along exceedingly well without any constitutions, simply working under the framework of the Dominion Constitution. Our states might very well experiment with some of the devices of parliamentary government as developed and applied in the Canadian provinces, such as the unicameral legislature (of which we have but one current example), an executive chosen from and responsible at all times to the legislature, and a small number of administrative departments each directed by a trained and permanent undersecretary. The Canadian provinces are assured of quick and positive action on all matters requiring legislation, since the executive is the controlling committee of the legislature and proposes all important measures. There are no executive-legislative deadlocks under this arrangement which cannot be quickly resolved, legislative action is easy and direct, and the separation of powers—that fiction which confuses us—is nonexistent. When a conflict does arise between the executive and the legislature, it is solved at once by simply appealing to the voters, who decide the fate of both the executive and the legislature at the same time. American states would do well to take note of how the neighboring provinces to the north operate governmentally under quite similar conditions.

CHAPTER II

EFFECT OF WAR ON COSTS OF LOCAL GOVERNMENT

Kenneth Dayton

Director of the Budget, New York City

A New York City official is not the one to talk on this subject because the problems in New York are not typical of those throughout the United States. As I see it, there are two main types of communities confronted by war problems. First, there are those communities where there has been a tremendous influx of population due to defense work. Such communities are immediately faced with the problem of great increases of governmental service to this increased population, with respect to fire protection, police service, health and sanitation, water supply, education, and all the other activities which a local government undertakes. Too often they are faced with these increased services without any substantial increase in revenue.

Then, there is the other type of community where there may well have been a loss of population and a loss of revenues as population and business activity have been drawn off to other cities where defense work has been undertaken on a large scale. On the one hand, this second group of communities faces the problem of continuing its normal service with decreased revenues and with increased prices, but, on the other hand, it is frequently able to make balancing savings due to a reduc-

tion in personnel and perhaps a reduction in the total of other expenditures for particular services.

The city of New York clearly belongs in the second class, but because of its size there is difficulty in adaptation to new conditions which may not exist in smaller communities. Certainly, its problems are not typical of American cities as a whole. As a matter of fact, I doubt whether there is any city which may be considered typical. Every one has distinctive conditions and distinctive problems.

New York City's Increased Costs

It may be suggestive, however, if I discuss those problems which confront the city of New York and the solutions which we see as possible, and then argue from the specific to the general.

I think it may help to orient the discussion if I call your attention to certain facts concerning the city of New York. In the first place, unlike most communities, the city of New York has two distinct budgets—an expense budget which covers all the normal operating and maintenance costs of the city for day-to-day operation, and a separate capital budget which includes all construction and is limited to construction. I have noticed in the comment at the regional round tables that financial officers frequently mention the saving due to the cessation of construction. In New York, because we have a separate capital budget, we do not think of decreased construction as giving us any saving. Our troubles are with the expense budget.

But the expense budget is not based purely upon city revenues. Out of the total $769,000,000 appropriated for

the current year only $634,000,000 came from city revenues; $135,000,000 is provided from other sources—$100,000,000 from state and federal contributions to various city activities, $19,000,000 toward debt service from certain transit operating revenues, and $16,000,000 from miscellaneous sources. Now I can tell you that this $769,000,000 figure represents a decrease of $43,000,000 from the budget of the preceding year, but out of the $43,000,000 only $20,000,000 was a saving in the expenditure of city revenues and the remaining $23,000,000 was a saving, or at least a decrease, in the expenditure of revenues from other sources. So when the city economized in the light of the war, the major benefit went to the state and federal governments.

Facing its first war budget, New York City has had to meet substantial added costs. The most obvious increase as a result of the war has been the expenditure for civilian defense. In the last fiscal year we had to spend $2,500,000 for this purpose which had not been provided in the budget, and already in November, 1942, with less than four months passed, we face another similar expenditure, of which a comparatively small proportion was foreseen when the budget was made up. All of last year's expenditures and the major part of those for the current year have had to be found outside appropriations specifically dedicated to that purpose. Fortunately, we made sufficient savings in other budget appropriations to absorb this increased cost.

Then we have had to make very substantial increases in the salaries of the lower paid categories of city employees. In the current budget we gave increases, which aggregated $1,600,000, to laborers and almost all other city employees in the lower salary scales. It seemed to

us when the budget was made up that these increases would take care of the situation for the current year. Unfortunately, we are already confronted with a need for still further increases if we are to hold the necessary staff for the performance of vital city functions, and within the last few days the mayor has announced the second increase for nurses and hospital attendants and helpers, which will increase expenditures in the hospital department another $2,000,000. This was absolutely essential because industry was drawing off our hospital staff to a point which threatened us with inability to furnish basic hospital service. Here again we have been able to absorb the increase out of other savings.

Despite the control which the federal government is exercising over prices I need not tell you that prices have, nevertheless, gone up. Particularly in the purchase of food and fuel we are confronted with costs well over a million dollars which we did not anticipate when we made up the current budget. While the biggest increase has occurred in the purchase of food and fuel, there has been an actual increase in a great many items for other than personnel service.

Then the city has found itself engaged in special activities for which no appropriations have been made because they were not foreseen. Every week a large number of sanitation trucks are taken off their ordinary assignments and devoted to scrap collection, and, indeed, recently when the scrap collection drive was at its height it was necessary to mobilize the trucks of a considerable number of departments, which meant that the city was furnishing gas and oil and thousands of employees for an entirely novel activity. As part of the scrap campaign it is proposed to tear up many miles of abandoned

car tracks, which would involve the city in the whole problem of replacement, then in the maintenance of the temporary pavement, and eventually would involve large expenditures for permanent repavement. These expenditures we may or may not recapture from the federal government but we have little expectation of being reimbursed in full.

Finally, the city is engaging in postwar planning on a large scale. Of course, because of our dual budget system, this is not an item in the expense budget and does not confront us with an immediate problem. Nevertheless, the capital budget as amended last June authorized the expenditure of some $22,000,000 for postwar plans, and that amount has been raised by several more millions in the capital budget now under consideration. If those plans should be carried out at the end of the war, they would involve capital construction costing some $700,000,000. To my mind, however, the really serious problem there is not the capital cost, because we have a constitutional limitation on city debt beyond which we cannot go. Either we have the money or we do not have it. But if we do have the money and undertake any such construction program, I hesitate to think of the expense budget problem which will result due to the increased cost for maintenance and operation of all these new facilities proposed. Personally, I cannot see at the present time how the city can possibly expect to absorb this increased operating expense.

Accompanying Savings

So far, I have given you a picture of the increased costs to the city as a result of the war. Against these I must

say frankly that we have had savings which, so far, have been even larger.

On the capital side the ordinary expenditure of $50,000,000 to $100,000,000 a year has been reduced to a very small amount. This affects the expense budget only indirectly by saving on debt service and by decreasing the new operating costs which we have had to absorb year by year.

There has been a very substantial saving in payroll costs. We have lost a good many thousands of the younger employees to the armed services, and other thousands who have chosen to leave their city work to go into higher paid positions in private industry. Sometimes we have had to replace these people, but in general we have left their positions vacant, and either the departments have absorbed the work with the remaining personnel, or in many cases the departmental services to the public have been curtailed. I think the public has been very willing to accept decreased services, realizing as it does the demands made upon manpower and upon money by the national war effort.

Just to give you an idea of the savings which were possible in this field, we dropped 6,500 positions from last year's budget for a saving of $14,000,000. Then on top of this we estimated an additional $14,000,000 in accruals due to continued decrease of personnel, and these estimated accruals were deducted from the appropriations to the various departments. Despite the fact that we have thus anticipated $28,000,000 in personnel savings, we are actually realizing savings at a rate which, if continued, will produce a further $4,000,000 during the course of the year. Whether this will continue

I cannot prophesy with any certainty. The $2,000,000 increase to the hospital employees which I mentioned before is an indication of the uncertainties which confront us in these estimates.

I said that the city was confronted with increased costs for food and fuel and other non-personnel expenditures. That is quite true, but it is also true that we are making savings in these fields because of our inability to buy the quantities of supplies and materials and equipment which the city would normally use. The rationing of gasoline has very materially reduced the purchases which we would normally make, and it is highly probable that forced savings in this field will be still larger before the year is over. The dim-out will, in my judgment, save us a million dollars in our lighting bill below the appropriation which we made, although the appropriation itself had already been cut because we anticipated a certain saving. I cannot even guess what the final balance will be as between the increased prices and the savings due to inability to buy, but certainly the limitation of supply will be a material contribution toward increased costs.

We should realize large savings in our welfare and relief costs due to greater employment in war activities. New York City is in a rather peculiar position in that respect. Not many months ago, because we have no large war industries, we were threatened with heavier unemployment at the very time when most communities were finding increased employment to have resulted from the war. Fortunately, the federal authorities have cooperated to a considerable extent in awarding special types of contracts within the city, and at the present moment if that policy and those activities continue, we shall real-

ize not only a $23,000,000 saving in welfare and relief expenditures which we estimated when the budget was made up, but a considerable amount besides.

Decreased Public Services

I said before that we had been able to make very large savings in personal service costs by decreasing public services rendered to the community. It may be suggestive if I name some of these.

The biggest saving is going to come in welfare costs, where the decrease is not in the service rendered to the needy but in the number of the needy who require the service.

There has been a substantial decrease in hospitals and health. We are not entirely happy about this because much of it is due to the loss of nurses and other personnel to the armed services or to private industry. And certainly hospital and health service is not one which we would willingly curtail. But it has been forced on us, and, fortunately, the more prosperous condition of many of the residents of the city has made some curtailment in the demands on the city for service, although not a curtailment commensurate with the decrease in personnel.

There is a large decrease in the school registers due partly to the fact that boys and girls who have normally continued their education through high school have left before graduation to go into war jobs, partly to the fact that families with children have moved out of the city to other communities to go into war industries, and partly to a decrease which would have existed irrespective of the war. That trend will reverse itself in a few years

because of the higher birth rate which will reflect itself in the schools as the children reach school age.

There is also going to be a decrease in the registers in the colleges because of the draft and because of war work.

So far, you will observe that, except to a limited extent in hospitals, the decrease has been not so much in service rendered as in service needed. But when you turn to an activity such as recreation, you will find that we have curtailed the expenditures for the Park Department simply because we did not have the money to furnish the service which would have been desirable. Expenditures for police protection and the Fire Department will drop materially due to curtailment of services. The decrease here is due largely to troubles arising out of the drafting of policemen and firemen within military age limits, and the fact that we cannot replace them except with other people who will be drafted almost as soon as they are appointed. In the Sanitation Department people have been willing to accept a less frequent collection of garbage and refuse, and that collection has been still further decreased by the diversion of sanitation trucks and personnel to scrap collection.

In public works the buildings are not being maintained at as high a standard as they would be during normal peacetimes, partly to save personnel and partly because we cannot get the repair items which we would like. Similarly, the expenditures of the borough presidents for street maintenance are reduced, due for the most part, to our inability to get materials which are necessary.

From my point of view, there has been one unique experience in all this—the willingness of department heads to cooperate in reducing expenditures. A year

ago I would have said that I never hoped to see the day when a department head was willing to take a dollar less than he had the year before. I would not want to say that they do it now with enthusiasm, but there is a noticeable change.

Shifts of Activity

In addition to the increased costs which the city faces as the result of new activities and increased prices, I think mention should be made also of certain shifts of activity within departments as the result of the requirements of the war situation. Just as an example, the city found it necessary last spring to establish a City Priorities and Allocations Board to deal with the problem presented by federal limitations upon supplies, materials, and equipment, and to hold the balance between the various operating departments of the city, so that where material was in short supply, a decision could be made on a city-wide basis as between competing city activities. This City Priorities and Allocations Board has been staffed from the Purchasing Department and other agencies, and, as a matter of fact, it has gone considerably beyond the mere allocation of restricted materials, with general studies directed to the most efficient use of the limited supplies which we have available. For example, under its supervision there is being conducted a survey of all motor vehicle equipment to determine what can be laid up, and how it can be operated and maintained more efficiently and more economically, and, particularly, what specialized equipment can be used by more than one department so as to avoid duplication of investment.

Of course, at the end of the fourth month of the fiscal year, it is absolutely impossible to estimate with any degree of accuracy what will be the actual financial outcome at the end of the year, but if things continue along the present course, I should suppose that the net savings over and above the increases due to the war might amount to some four or five million dollars. In itself this is a pretty substantial sum, but you will remember that it must be compared with the $769,000,000 total of the expense budget. And you must consider further that in a budget of that size it is very easy for it to be wiped out almost in a single action, such as the necessity of a wage increase for any large group of employees.

If we look at the New York picture solely from the point of view of expenditures, you will get the idea that we are in a reasonably comfortable situation at least for this year. I cannot too strongly emphasize the fact that this is not a fair presentation of the city's financial picture. It is a presentation only of the expenditure side. I have not mentioned revenues, because the revenue problem is the subject of discussion elsewhere in this volume. But it is on the revenue side that New York City faces its real difficulties. It is enough to say now that as far as I can estimate the situation at present, the city will go into the next fiscal year with mandatory increases and decreased revenues which will aggregate $30,000,000. This shortage is going to present a very serious problem. On the one hand, as you all know, the problem of getting more revenues for cities today is almost impossible, but, on the other hand, the expectation of making any such amount of economies on top of those already realized seems equally impossible.

Future Problems and Policies

So much for the New York City picture. I do not know how far the elements which make up the New York City problem are common to other cities which, like New York, are not confronted with the special problems arising out of a sudden increase in industrial war work. I should suppose that in many respects the situation in these cities would be identical in kind with that in New York. In one sense it is easier to adapt oneself to new conditions in a large budget such as we have in New York City, because there is so much potential leeway in the various appropriations. But, on the other hand, it is not as easy to shift personnel in as complicated a structure as we have from one activity to another, or to curtail in one field and expand equally in another. There are just too many people involved. Where you have a payroll of 200 you can see what each man is doing and what the effect is going to be of transferring him, but where you have 200,000 a shift is a very different problem.

When you turn to those cities where there has been a marked expansion of industrial war work, it seems to me that you must run into problems concerning which I certainly am not competent to speak. Every existing community service may well be overloaded—water supply, transportation, education, fire and police, and housing, just to mention a few. No one who has not actually been through the experience can appreciate the intricacies of those problems, the makeshift remedies which have been forced upon these communities by the sudden demands, or the additional complications which arise out of the lack of relationship between revenues under the new conditions and the demand for increased services.

I have indicated that at the moment the city of New York is getting along fairly well under war conditions, although it is faced with a most serious revenue problem in the succeeding year. It would be a mistake, however, to assume that even on the expenditure side, the present situation will continue throughout the war. Higher wages and higher prices through inflation hang as a constant threat over every municipality. So do extra costs for maintenance and operation because of inability to secure ordinary repair materials under priority regulations. Frequently, the cost of replacing a damaged water pipe is going to be higher with some makeshift arrangement than it would have been if you could have bought a new pipe and installed it. After the war, there are going to be tremendous and immediate problems of expenditure for deferred maintenance. All the money that we save now will have to be provided then, and provided in larger amounts because the deterioration of plant is progressive. Finally, all of the money which we are saving on personnel is going to have to be found immediately after the war, because communities are going to have to find places for their employees now in service. And you and I know that as a practical matter we are going to have to find places for them and find the money to meet their payrolls, irrespective of the financial condition of the cities or the need for the jobs at that time.

In reading the digests of the regional meetings, I have been a little surprised to see how often a suggestion was made for the accumulation of surpluses during the war period. It does not seem to me that this is a sound policy. The people of this country are carrying a tremendous tax burden because of the national war

effort. I doubt whether most of them yet realize what that burden is. They will realize it next March 15—in part at least. It seems to me that we owe them every consideration possible in the reduction of the local tax burden, and we owe it, too, to the federal government to clear the way as far as possible for federal taxes and federal borrowing. It is quite true that many residents of any community make no direct tax payment which they recognize as such. Every one of them, however, carries the tax burden either directly or indirectly. Furthermore, since communities depend largely on the real estate tax and on levies upon business transactions for their revenues, they cannot afford to overlook the fact that the real estate owner, himself, and business carry their own increased federal burden, and, if the margin of profit is as small as it is in New York real estate and in many New York businesses, they cannot afford to meet the federal demands and still pile up surpluses for localities.

Many economies are being forced upon local communities. In my judgment those economies ought to be passed on to the taxpayer immediately, but, in addition, I suggest that it is the duty of communities to make more and to pass on the additional savings. Communities can make their own contribution to the war effort by the money which they save and release for national use, by releasing manpower, and by releasing materials. And in making those contributions to the war effort, they help also to meet their own immediate financial problems.

CHAPTER III

EFFECT OF INFLATION ON THE COST OF GOVERNMENT

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Definite limits for this paper are set by the program committee. First is the restriction to finances of state and local governments. Second is the assumption of inflation. Taking it for granted that inflation will occur, what will be the effects on the costs of state and local governments?

There are, however, two points on which there is no restriction. First is the meaning of inflation. This word is used very generally but with little agreement and, in most cases, very vaguely. President Roosevelt has recognized the confusion and has attempted precision with the expression "a rise in the cost of living." He had in mind a rise in prices that might increase money expenditures without a rise in real standards of living and without a corresponding advance in money incomes. If this should occur, real incomes for those thus affected would decline. This was a most suitable way of making clear to the general public the current issue for each of them as an individual.

Perhaps this same approach will be helpful in this symposium. We are concerned with the effect of inflation on "the cost of living" of state and local governmental units. If inflation occurs, will it raise or lower

the incomes of these governmental units and will it increase or decrease their expenditures? Or, if both are affected, will its impact be greater on one than on the other? For example, incomes might be increased enough to offset, or more than offset, any increase in expenditures, or the opposite might occur. Several combinations are possible.

The second point for decision is the amount and rapidity of inflation. Even if it is assumed that inflation will occur, will this inflation be very slight or moderate or considerable, and will it be rapid? A very slight and slow rise in the cost of living of state and local governments might be quite unimportant. A rise comparable to the one in Germany that came to a climax in 1923 would be catastrophic. Between the two extremes there are an indefinite number of possible gradations. Since we are dealing with unknowns, we may assume a somewhat moderate advance such as occurred in the United States from 1915 to 1920. Taking the Bureau of Labor index of wholesale prices as the measure, the advance in that period was from 100 in 1915 to 240 in 1920, or an increase of 140 per cent. With the attempts now being made to prevent a rise in prices, it does not seem unreasonable to assume that the advance will be no greater.

Inflation would affect government costs through (1) higher operating expenses due to an advance in wages of employees and in cost of supplies, and (2) similar advances in any outlays made for labor and materials used in improvements financed through borrowing. These latter advances might swell the total debt, perhaps to an extent that would make carrying charges

difficult or even impossible, especially later if the inflation were followed by a subsequent deflation.

During the earlier period in the United States there was a sharp rise in the cost of state and local governments. The total of such outlays in 1913 was about $2,200,000,000. Moreover, the functions performed by these units were chiefly in the essential services. These expenditures are now about $9,000,000,000 per year or over four times as much. A second consideration is the lack of restrictions on expenditures for improvements in the earlier period and hence a growth in indebtedness. Total indebtedness increased greatly.

Of course, it would not be correct to assume that the experiences of some twenty-five years ago will be duplicated. Thus there may not even be any inflation, or at least no important amount of inflation now. But this paper assumes that there will be. Accordingly, we must ask ourselves what impact, if any, this assumed inflation may have upon governmental costs. We may first discuss receipts and then expenditures.

Government Receipts from Taxes

If prices rise, will receipts of state and local government be increased? A few comments may be made regarding the leading receipts in 1941. Although taxes on property have declined in relative importance, the total is still large, particularly for local governments. It accounted for $4,445,000,000, or 93 per cent of the revenues of local governments, and $4,689,300,000, or 56 per cent for local and state governments combined. Many of us would like to know the future course of real estate values, but the writer would suppose that

any general rise in prices of the sort we are assuming would include real estate values. If rates remain the same, revenues from this source will increase and particularly assist local governments.

It does not follow, however, that this advance, if it occurs, will be uniform throughout the country. The pressure upward will be greater, for example, in areas where defense and related activities are concentrated. They will be less in other areas, some of which will suffer from the depressing influences on real estate arising from decentralization and other causes.

Second in importance, particularly for the states, are the general sales and use taxes. They yielded the states $869,000,000, or about one-quarter of the total, and for state and local governments combined about 11 per cent. Their future yield seems to depend on the decision of the federal government. If Congress should enact and the President should sign a bill providing for a general sales tax, the various state governments not only could not well increase revenues from this source but might even be under heavy pressure to withdraw from the field.

Next are receipts from taxes on gasoline and motor vehicles which are third and fourth respectively in the amounts yielded. They may be treated together. The total from the two sources was for the states $1,383,000,000, or nearly 39 per cent of total revenues. With the shortage of rubber and with restrictions on the use of gasoline, these receipts will presumably be greatly reduced and will remain low until rubber and gasoline are more generally available. When this will be the case the writer does not hazard a guess.

Income taxes are used by a number of states and to a very slight extent by local governments, where what is known as the wage tax is imposed. With the federal government increasing rates and lowering exemptions, there would seem to be little possibility of the same action by state governments. But with the great increase in the national income, existing rates imposed by the states should materially increase the yield from this source. Their yield in 1941 was $435,543,000, or about 12 per cent of the total state revenues. Presumably the same position can be taken toward the inheritance, estate, and gift taxes, which in 1941 yielded $119,830,000, or, slightly over 3 per cent of the total state tax revenues.

It will be seen that any conclusions drawn are somewhat speculative. It seems probable that local government tax receipts will be maintained because of the reliance of local governments on real estate as a source of revenue. State government receipts may be affected adversely because of heavy dependence on gasoline and motor vehicle taxes, and because some of the other sources of state revenue are in fields competitive with the federal government. It should be noted, however, that state income taxes will presumably yield larger returns even though there is no increase in rates and no lowering of exemptions.

Expenditures

To the extent that there is inflation there will be certain increases in state and local government expenditures. Shortages of supplies and of labor and the rising "cost of living," which will be felt by workers and

increase their demands for higher pay, will mean an increase in outlays. Illustrations are numerous. One that comes to attention is the outlays in Philadelphia during 1942 which were in excess of appropriations made at the beginning of the year and the call for larger amounts for the year 1943.

Attention was called above to the fact that in 1914 the expenditures of state and local governments were largely for "essentials" and that since that time a considerable part of the increase in outlays is for "nonessentials." To the extent that this is true, some economies can be effected, although it should be remembered that the public quickly becomes accustomed to any line of public service and dislikes to see it eliminated. Some reduction of services may be possible, however, which will offset the increased cost of those still furnished.

Another reduction can be secured through retirement of old debt and through refundings at lower rates. This will reduce debt service charges and it will be aided further by the removal of tax exemption features on new federal bond issues. These may be contrasted with the situation from 1915 to 1920 when debt increases were possible, and actually occurred on a considerable scale. In addition to what has just been said, attention can be called to the following further influences: (1) the shortage of materials for public improvements due to priorities and allocations arising out of the war program; and (2) possible federal restrictions on new state and local bond issues. This has already been reflected by a shortage of municipal bond issues in the hands of dealers. It was recently noted in current news that municipal bondholders now have on hand the smallest supply of new issues in twenty-five years and are bid-

ding sharply for such bonds as are available. It is said that there are less than $50,000,000 of issues now left in dealers' hands, with little prospect of an increase.

Postwar Period

Thus far, reference has been made to inflation during the period of the war. It is, of course, risky to assume that we shall have an exact repetition of the experiences of twenty-five years ago, but such an assumption is more reasonable than any other, so let us take it for granted that any rise in prices that occurs will continue for say two years after the war ends. If this be true, costs of labor and material will continue to advance. Many outlays of the federal government will continue at a high level, and state revenues will probably respond slowly. During this period, presumably local revenues will remain high since as already stated they come largely from real estate, with debt servicing probably not a serious burden for reasons already mentioned. Expenditures for these purposes will presumably be held down.

If we again assume a general repetition of the past, there will sooner or later be a fall in prices. In so far as inflation is held in check, the seriousness of this deflation will be reduced. Also in so far as the many plans for preventing deflation may be effective, its seriousness will be lessened. While we may hope for a measure of success in both of these particulars it would be highly optimistic to think that no reaction will come.

If and when it comes and to the extent that it does, there will be a decline in most sources of public revenue, but there will also be possible a reduction in govern-

ment operating expenses. The seriousness of the decline in revenues will be softened from that of some years ago, because state and local debts will not have increased and debt service charges will have been kept down or even lowered.

PART TWO

WHAT THE WAR IS DOING TO STATE AND LOCAL REVENUES

CHAPTER IV

EFFECT OF WAR ON STATE-COLLECTED REVENUES

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Among wartime students of taxation or state administration, few parlor games are so exciting as making estimates of the productivity of state taxes in the future. The game can be varied a good deal, first by type of tax and second by period of time. The period of time may be the duration of the war or next year or next month, or it may be the current month, or perhaps the preceding month—statistics on a weekly, daily, or hourly basis not having yet replaced the formerly adequate annual information.

Despite the considerable amount of centralization that has resulted from the great depression, followed by the defense period and now a year of bitter war, there are still many people who recall that our country is a federalism and who retain a genuine interest in maintaining the forty-eight commonwealths that together comprise that federalism. Even in time of war there are the continuing state activities which must be financed. And then there are the postwar state activities; they too must be financed. State revenue systems cannot go unnoticed by tax students in favor of, say, problems of fiscal policy at the national level. Indeed, state revenue

systems must not be wholly ignored by the general public even in favor of Guadalcanal and Bizerte.

One of the major wartime problems is: What has happened, what is happening, and what is *going* to happen to state revenues during this war?

Current Role of the Bureau of the Census

Phrasing the question that way prompts me to pause right here and mention what seems to me to be the new, the current, the still-changing role of the Bureau of the Census. The Bureau's work in the field of state finance started—in a modest way, of course—back in 1850. That was decennial work. The annual work began in 1915 with the inauguration of the well-known series of statistical reports called *Financial Statistics of States.*[1]

Back in 1915, and for two decades thereafter, the point was to compile state fiscal data with great precision—sometimes with specious precision—and to present the data for public consumption only after all the arithmetical items were in and carefully checked. During the past few years, however, the Bureau, without sacrificing quality, has placed increasing emphasis upon promptness. The result is that today we frequently receive requests, not only for current information, but also for estimates of future data. This year we had our 1942 report on *State Tax Collections* out on the street, so to speak, before the close of August, and the 1942 report on *State Debt* was published early in November.

Responding to the demands for information on what is *going* to happen, we are now inaugurating a survey of

[1] Beginning with the reports for 1942, the title of this series is being changed to *State Finances.*

state budgets presented to state legislatures in January, 1943. For war purposes, especially, any nationally summarized knowledge of the fiscal plans and expectations of the states is important. A report of this analysis will be published before the close of March. In addition to the prompt release of statistical data, textual analysis and interpretation now accompanies each report, and related statistical and nonstatistical information is drawn upon. The recruitment and appointment of a number of qualified specialists has enabled the Bureau at least to begin to meet the demands both for prompt information and for statistics on which to base predictions. If the decision to get up to date had not already been made, the war would surely have forced that decision.

War and the Leading State Revenue Producers [2]

I am here today to tell you the results of my own thinking on the subject of war and state revenues and to pull together from various sources some pertinent statistics. Let us consider each of the leading producers of state revenue. These are pictured in the accompanying chart.[3]

Individual Income Taxes

Income taxes are slow to reflect changing conditions, because they are paid on the previous year's income. Thus, 1942 income tax collections, being based ordinarily

[2] Unemployment compensation taxes, because they are dedicated to the payment of unemployment benefits, are not considered.

[3] The Census classification of state taxes (see table on page 42) has been altered for purposes of the present paper.

STATE TAX COLLECTIONS IN 1942, BY TYPE OF TAX

Type of Tax	Amount [a] (in millions)	Per cent distribution: Including unemployment compensation taxes	Per cent distribution: Excluding unemployment compensation taxes
Total collections:			
Including unemployment compensation	$4,951.5	100.0	......
Excluding unemployment compensation	3,872.3	78.2	100.0
Sales and gross receipts taxes	2,233.3	45.1	57.7
General sales, use, or gross receipts taxes	626.1	12.6	16.2
Motor fuels	937.9	18.9	24.2
Alcoholic beverages	252.3	5.1	6.5
Tobacco	130.0	2.6	3.4
Other	287.0	5.8	7.4
License and privilege taxes, and permits	653.3	13.2	16.9
Alcoholic beverages	56.5	1.1	1.5
Chain stores	4.0	.1	.1
Motor vehicle and operator licenses	417.2	8.4	10.8
Hunting and fishing	24.7	.5	.6
Other	150.9	3.1	3.9
Individual income tax [b]	245.0	4.9	6.3
Corporation net income tax [b]	277.3	5.6	7.2
Property taxes	262.0	5.3	6.8
General	166.8	3.4	4.3
Selective	95.2	1.9	2.5
Death and gift taxes	113.5	2.3	2.9
Severance taxes on natural products	61.8	1.2	1.6
Other taxes	26.1	.5	.7
Unemployment compensation taxes [c]	1,079.2	21.8	......

Source: Bureau of the Census, *State Tax Collections: 1942*, Supplement.

[a] These amounts were collected by 41 states during their fiscal years ended between March 31 and June 30, 1942, and by 7 states whose fiscal years ended between August 31 and December 31, 1941.

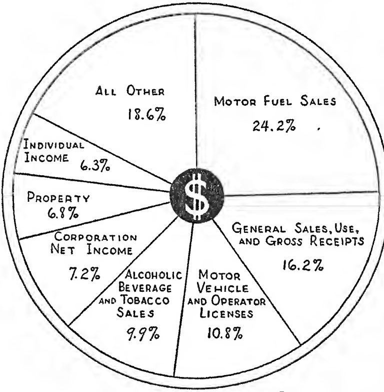
[b] Taxes on individual incomes and on corporate net incomes were reported as undistributed totals by 6 states. Estimates of the distribution have been made on the basis of the average of the experiences in those states that have supplied separate returns. Individual income taxes were 52 per cent of total income taxes in 1942.

upon calendar 1941 income, reflect the defense era and not war conditions.

Current information is available from the Census report on *State Tax Collections* for 1942 (see table on page 42). Omitting states in which rates changed, omitting

SOURCES OF STATE TAX DOLLAR 1942 FISCAL YEAR

(Exclusive of Unemployment Compensation Taxes)



BUREAU OF THE CENSUS

states which do not segregate individual income from corporation income tax revenue, and omitting states in which the fiscal year ends in the last half of the calendar year, we get a group of seventeen comparable individual income tax states for the last three years. Of those seventeen states, only one showed a decrease in 1941 from 1940, and only two showed a decrease in 1942 from

1941. Ignoring these exceptional cases, and limiting ourselves to comparable data, we may say that the individual income tax receipts were up 13 per cent in 1941 and then 40 per cent in 1942, a spectacular increase.[4] This increase may be attributed to the so-called prosperity induced by our nation's preparation for war, although some of the increase is due to the partial inflation we have already had.

Income tax collections next year, based on this year's income, should be still higher—unless, of course, too many states follow the example set by New York and reduce rates. It may be noted in passing that California's productive tax remains in force since the attempt to repeal it at the polls on November 3 was unsuccessful.

Corporation Income Taxes

What I have been saying about individual income taxes applies, in general, to corporation income taxes also. From those states that segregate the yields from the two taxes (and we in the Census think they should be separated, because really the two taxes are radically different), we estimate that there was an increase in fiscal 1942 over fiscal 1941 of 51.4 per cent in the corporation income tax yield. This extraordinary increase, like the one in individual income tax receipts, may be attributed to the war, or rather our preparation for war. California, Connecticut, New York, North Carolina, Pennsylvania, and Wisconsin clearly showed the effects of war

[4] Taking all the states with individual income taxes, the increase in 1942 is only 3 per cent, chiefly because New York's 25 per cent reduction in rates and the repeal of its one per cent emergency tax resulted in a striking decrease in yield.

orders through the increase by millions of dollars in their tax collections from corporate incomes. These collections will probably continue to rise for another year, but the 1944 collections ought to be but little different from those for 1943, because by 1943 we may have arrived at the wartime peak of our corporate activity.

Gasoline Taxes

No question exists over the fact that the gasoline tax is the outstanding war casualty in the state tax family. This is evident, however, not from annual data, because the collections were greater in fiscal 1942 than in fiscal 1941. It was not until March, 1942, that the turning point came, reflecting automobile rationing and tire shortages. Since then, each month shows smaller and smaller collections in both the seaboard states and the rest of the country, reflecting the rationing of gasoline and tires. Now comes nation-wide gasoline rationing, with still greater declines in tax yields sure to follow.[5]

I wish, now, to call your attention to the uneven effect of this unprecedented decline in this extremely important tax source. Some states depend upon the motor fuel tax for as much as two-fifths of their total tax revenues; these are Nebraska, Florida, and Georgia. On the other hand, New York relies on the gasoline tax for less than one-eighth of its tax revenues; for New York, unlike the other states mentioned, the gasoline tax changes caused by war conditions will be less serious. Furthermore,

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[5] The temporary card system of rationing in the seventeen Atlantic seaboard states became effective May 15, 1942, and the permanent book system became effective July 23. Nation-wide rationing, effective December 1, will cause the decline in the gasoline tax yield at first to be more severe and later to be less severe than originally supposed, the life of tires being prolonged.

some states are free to use a sizeable portion of the gasoline tax revenue for general purposes, as in New York; other states tap the gasoline tax for such specific purposes as relief, as in Rhode Island, or for education, as in Louisiana. Still other states have to devote a substantial portion of the gasoline tax to debt service, as in Louisiana and West Virginia. Massachusetts relies but little on the gasoline tax, but she has a problem all her own; how is she to pay the debt service on the five-year bonds that were issued to finance highway repairs made necessary by the hurricane of 1938, and at the same time take care of proper highway maintenance?

Thus, war conditions as relayed on through the gasoline tax are bound to hit some states much harder than others. We must be careful of our generalizations.

Motor Vehicle and Operator Licenses

Curtailment of automobile traffic—to many civilians the best reminder of our new war economy—will surely result in the registration of fewer private automobiles, which will, in turn, result in substantially smaller state revenue, although the lag will be even greater than in the case of the gasoline tax. Tires are bound to go out of service, unless a satisfactory synthetic process can be put into use next year. The loss of even one of five tires will serve to put many a car up for the duration. Therefore, we may expect a drop, both in the registration of private passenger cars and in the number of operator licenses in 1943, followed by a more severe drop in 1944, all of which will cost the states considerably in decreased revenues. State receipts from motor vehicle and operator licenses are less often earmarked than gasoline tax

revenues, with the result that most state general treasuries will feel the pinch.

Again we may expect an unevenness throughout the country, depending upon the location of defense plants, the availability of railroad transportation, etc.

General Sales and Use Taxes

As I see it, the biggest question mark in the state revenue field today is the general sales tax and its handmaiden the use tax, which together accounted for a sixth of the aggregate state tax revenues in 1942. One school of thought holds that, because of the tremendous upswing in business and trade, millions of wage earners will shell out their new-found ready cash for something—that there will be no stopping them, and we might as well recognize it. Look at the figures, they say. Omitting Illinois and South Dakota (which operated under reduced rates in fiscal 1942), and omitting Louisiana (where the sales tax had been repealed[6]), the 1942 gains in general sales taxes averaged 24 per cent over 1941.

But here again, annual data—even though hot—need to be supplemented by additional knowledge in order to do any extrapolating. Clear through calendar 1941, consumers could buy anything they wanted, and they had more to buy with. Restrictions and rationing were not really reflected, as a matter of fact, until last April, which, according to the revised figures of the Bureau of Foreign and Domestic Commerce,[7] was the first month since November, 1938, in which retail sales were less than the

[6] It was re-enacted at the 1942 session of the Louisiana legislature and became effective September 1.

[7] See *Survey of Current Business*, August, 1942, pp. 24-25 (also the Weekly Supplement thereto for October 29, October 8, September 3, and August 6).

corresponding month in the previous year. Nation-wide retail sales (more properly "sales at all retail stores") in each of the four months following last April were less than in the corresponding month last year. As retail sales fall, so will there be a tendency for retail sales taxes to fall. More specifically, two of the outstanding sales tax states, California and Illinois, have reported serious declines in their recent-month revenues from the sales tax; both have indicated that "the boom in retail trade has reached and passed its peak"[8] and that "there are unescapable indications of the beginning of a decline."[9] Certain other states are experiencing declines also.

There are indications of some unevenness, however. For example, the sales tax revenues have shot up in certain states, especially Alabama and Mississippi, owing to strenuous activity in the field of shipbuilding and other defense work. Moreover, the recent-month downward trend in retail sales throughout the country was halted (or should I say interrupted?) in September. Does this indicate a renewal of retail buying with concomitant increases in sales tax receipts?

Taking a larger view, let us ask ourselves, just what can be *bought* in the coming year or two under our restricted wartime economy, and therefore, just what can be expected of the sales tax in those states that have it?

First, what about consumers' durable goods? Well, anybody knows that in the next year or two there will be

[8] Dixwell L. Pierce, "[California] Sales Tax Revenue Falls," *The Tax Digest*, October, 1942, pp. 329-31, 349-50.

[9] George B. McKibbin, "Wartime Fiscal Problems in Illinois," *State Government*, November, 1942, pp. 213-14, 220-22, 224. Had the proposal to exempt food from the operation of the sales tax been adopted at the November 3 election, the yield might have decreased by a fourth. (In point of fact, the measure received an overwhelmingly favorable vote, but it failed of adoption because it did not receive the approval of the majority of those voting at the election.)

little buying of automobiles, refrigerators, lawn-mowers, vacuum cleaners, radios, alarm clocks, or perhaps even furniture. Not only will there be less production of durables; what there is available will have to be bought under the new restrictions on installment buying.

Secondly, what about semidurable goods? Well, except for cotton-made goods, the outlook for goods made of rubber, wool, silk, and perhaps leather is not favorable. Even if shipping difficulties should prevent our exporting much of the clothing needed by our armed forces and by our allies, the present rate of retail sales of consumers' semidurable goods seems unlikely, because many factories may cease their manufacture of less essential articles and perhaps even close shop for the release of manpower for war work.

Thirdly, what about perishable goods—foods? Well, until "the greatest overseas invasion in history," the American invasion of North Africa on November 8, the outlook for the retail sale of food at home was reasonably good for many months, although not after that. Now the home shortage of food—at least certain kinds—may conceivably be a thing of the near future. It is hard to tell.

Finally, what about consumer services? Can people put their money into circulation by means of spending for services from others, who in turn could buy things at retail? Well, if there are to be the shortages I have just mentioned, the answer is obviously *no*. Anyway, with the need for labor everywhere, in defense plants, on the farm, in government—in the barber shop, the theater, the street car, and the Census Bureau—there is bound to come a decline in consumer services.

Thus, the argument that because of our prosperity (false or not) we are going to have cash in our jeans, that we are going to spend it, that the sales tax revenues will, therefore, increase—this argument seems to me to be specious, except, as I said before, there will be striking state-by-state variations.

Liquor and Tobacco Taxes

Liquor and tobacco taxes are merely selective sales taxes. An exception, of course, is the liquor revenue derived from the sale of liquor by state alcoholic beverage monopoly systems in sixteen states. Despite the end of distillation there seems to be no imminent shortage of either booze or smokes; and the demand continues, because iced tea and dried rose leaves seem to be unacceptable substitutes! In most states the revenue from the sale of these products is increasing and bids fair to keep on increasing.

Property Taxes

In fiscal 1942, property tax levies, the main source of revenue at the local level, brought a negligible gain in state revenues. The general property class increased 6.2 per cent, but selectively taxed properties gave a 5.6 per cent smaller return than in 1941. Although the majority of the states imposing a tax on general property reported larger receipts than in 1941, the total was noticeably offset by declines in ten states. Some state governments depend not at all upon property levies, but a fourth of the states get a considerable portion of the

revenues from that source.[10] With less tax delinquency in the property tax field, owing to the relative affluence of taxpayers, the outlook for the duration is reasonably bright at the state level. What will happen at the local level, or what will be the effect of the withdrawal from ad valorem taxation by virtue of the federal government's acquisition of more and more property, I am not prepared to say.

Federal Aid

By far the greatest nontax source of state revenue is aid from Uncle Sam.[11] Although there will be some shifts in emphasis, as indeed there already have been, the aggregate of grants from the federal government to the states may continue somewhere in the present neighborhood. For example, grants in connection with the social security program increased slightly in the fiscal year 1942 compared with the previous fiscal year, and no curtailment seems imminent; aid for highways, even though limited now to grants for strategic defense roads, appears to be maintaining its position of importance, but the beneficial effects of federal-state aid along this line will surely not be felt evenly among the states.

Factors Making for State Revenue Uncertainty

From the above analysis of state revenue prospects, there appear a few certainties and many uncertainties.

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[10] For a prewar statistical analysis of the property tax, *see* Bureau of the Census, *Property Taxation: 1941*, State and Local Government Special Study No. 22, September, 1942.

[11] For a prewar statistical analysis of federal aid, *see* Bureau of the Census, *Federal and State Aid: 1941*, State and Local Government Special Study No. 19, April, 1942.

The individual income tax, the corporate income tax, taxes on liquor and tobacco—these state imposts appear to be capable of continuing their high productivity and perhaps even of increasing for some time, although the yield of the corporate income tax may flatten off beginning with the collections of 1944. Federal aid and the property tax ought to hold their own. Decreases—severe ones—are certain in the gasoline tax and in motor vehicle and operator licenses.

Among the uncertainties already mentioned are, first and foremost, the uncertainty of the yield from general sales and use taxes, especially as among different states, although in general, I am doubtful that the sales tax can be relied upon quite so heavily as in the past year. Other uncertainties mentioned are the variations in the state-by-state effect of both the gasoline tax decline and the downtrend in motor vehicle licenses.

Without discussing them, let me just list ten other uncertainties. Here they are:

1. The degree of success the United Nations may have in the war.
2. Whether tax sources are, or continue to be, earmarked for specific purposes, as, e.g., Massachusetts' new 5 per cent tax on meals costing one dollar or more, the revenues from which Massachusetts will dedicate to old age assistance.
3. Whether new taxes are levied, especially individual income, corporate income, and retail sales taxes in those states not now having them.
4. Whether certain existing taxes are repealed or modified.
5. Whether and to what extent states decide to subject to sales taxation the sale of tangible property when sold to contractors under cost-plus-fixed-fee contracts.
6. The degree to which hiked federal income tax rates will result in increased deductions from state income taxes.
7. The degree to which citizens are prevailed upon to buy war bonds instead of goods.
8. The possible turn in federal fiscal policy, as, e.g., the enactment of a nation-wide sales tax.

9. The very attitude of incumbent or newly elected state administrative and legislative officials toward national fiscal policy, as e.g., sympathy or lack of sympathy with the stabilization program.
10. The degree to which rising price levels can be checked.

Need for Constant Study

With the lightning-quick changes we are experiencing, best illustrated by the activities first at Pearl Harbor and then in North Africa, we must be prepared to expect all manner of changes in our daily lives, and many of these changes will have direct or indirect repercussions in the field of state revenues. This fact points to the tremendous need for study and more study. No one can speak with too great assurance of months to come.

The popular impression is that state revenue systems are in good shape—at least in shape to produce highly satisfactory amounts of revenue. I do not say that the state governments are in bad fiscal position, but I do say that some of the talk about the current state surpluses may turn out to be beside the point. Some of these surpluses may continue, but many of them may not—for a variety of reasons.[12] Therefore, it seems to me that state officials and associations of taxpayers should count to ten before urging the repeal of tax laws or the reduction of tax rates and should consider the feasibility of retiring outstanding debt (in cases where all or a portion of the debt is callable) and also the desirability of investing, as certain states have, in war bonds for future expenditure on planned, useful public works. At the same time care should be taken to see that current state expenditures are made wisely, that state governments withstand

[12] Aside from the many revenue uncertainties, and aside from the unforeseeable new duties that may be thrown on the states because of war, there is the question of salary increases that may be necessary in order to retain essential state government personnel.

pressures to undertake new functions not generally beneficial, that, indeed, constant attention be given during this war not only to state revenues, not only to state fiscal policy as it affects and is affected by national fiscal policy, but also to the preservation and improvement of effective government in each of our forty-eight commonwealths.

A CONCLUDING NOTE

In February, 1941, the National Association of Manufacturers polled the members of the American Economic Association on the question, "Will There Be a Post-Armament Depression in the United States?"[13] Of those replying, the answer was overwhelmingly *yes*. Of course, some thought is now being given to the prevention or mitigation of such a depression,[14] but hardly anyone expects that there would be much success without the continued accumulation of information, both statistical and otherwise, or without the active leadership of government. Fortunately, much of the needed information is being accumulated by such private agencies as the Tax Institute and by official state and federal agencies, and this work should continue. As to governmental leadership, much of it can and should be exerted by government at the state level; if at the close of hostilities, the states are fiscally or administratively unfit, as they were a decade ago, there will surely arise public entreaties for federal rescue. To state government officials, a few of whom may hear or read my words, I say: This is a day for fiscal statesmanship.

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[13] *Can We Avoid a Post-Armament Depression?* National Association of Manufacturers, June, 1941.

[14] There are some who now, because of the accumulation of disposable funds in the form of bank deposits, fear a short period of inflation following the end of the war but preceding the onset of depression.

CHAPTER V

EFFECT OF WAR ON PROPERTY TAX COLLECTIONS

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Preliminary reports for the year 1942 from the finance officers of leading cities in the United States were exceptionally optimistic. Property tax collections, considered to be a fairly reliable index of a city's finances, showed marked signs of improvement. Most municipalities experienced a decided uptrend in collections, both in current levies and in the liquidation of tax arrears. Several cities reported the best collection experience on record while others pointed to a new low in delinquencies. Guided by these surface indications, the net effect upon local finances of this first year of war appears to have been extremely favorable. Does a more careful analysis of municipal revenues lead to this same conclusion? What will be the long-run effect of the war on property tax revenues?

World War I and Local Revenues

Trends in the finances of American cities during the last World War would seem to justify some of the present optimism exhibited in city collectors' reports. Total revenues for 146 cities having populations of 30,000 and over[1] jumped from \$865,000,000 in 1915, to \$968,000,000

[1] Bureau of the Census, *Financial Statistics of Cities: 1915* through *1919.*

in 1917, $1,015,000,000 in 1918, and $1,104,000,000 in 1919. Thus, in the first full year of war (1918), municipal revenues mounted 5 per cent above what they were in 1917 when hostilities began. With the return of peace in 1919 local revenues rose an additional 9 per cent and continued to increase abruptly in subsequent years. Property taxes, traditionally the mainstay of local revenues, accounted for most of these gains. The trend in total revenues and in general property tax receipts is shown as follows:

PER CAPITA COLLECTIONS IN 146 CITIES FOR SELECTED YEARS

Year	Total Revenues	General Property Tax
1913	$28.55	$17.82
1915	30.00	18.73
1917	31.97	20.57
1918	32.76	21.17
1919	35.26	23.29
1922	53.57	35.85

In the four years up to the entry of the United States into the war (1913-1917) total per capita revenues rose 12 per cent while general property tax receipts increased 15 per cent. In the four years following the war (1918-1922) total revenues soared 64 per cent more and property tax receipts were 69 per cent higher. In the Group I cities (with populations of 500,000 and over) property tax receipts showed a net rise of 85 per cent from the prewar years to the period of postwar reconstruction (1913-1922). In cities with populations of 300,000 to 500,000, the average rise in property tax revenues was 95 per cent. The smaller cities experienced the largest gains in revenue from this source, with average increases of well over 100 per cent for the period.

Before the last war, property taxes yielded approximately 63 per cent of municipal revenues. In 1917, receipts from general property taxes were 64.3 per cent; in 1918, 64.6 per cent; and in 1919, 66.0 per cent. The same trend is evidenced in a study of assessed values. In 1916, the aggregate value of property assessable for city tax purposes was reported as $35,338,012,000 for municipalities with populations over 30,000. In 1918 these cities reported a rise in the tax base to $37,739,343,000. Real estate values in these cities increased from $27,859,985,000 to $30,400,974,000 during the same period. In 1918, the United States Bureau of the Census, reporting combined financial statistics for 227 cities stated that "of these, 80 realized enough from revenues to meet all their payments for expense, interest, and outlays and to have a balance available for paying debt."[2]

In the last war, then, local finances were not seriously threatened. On the contrary, revenues, particularly property taxes, rose steadily and moved into new high ground in the postwar years. War demands and the movement of troops accelerated tendencies toward urban growth. Greater expenditures for services and supplies resulted in higher prices and larger incomes. This was soon transmitted to urban rent levels and property values. At first these new monetary valuations were simply a reflection of the reduced purchasing power of money. The 1913-1914 depression had dampened speculative enthusiasm in land buying and building construction and had slowed down activity in the real estate markets. The recovery in real estate lagged behind the general revival in business stimulated by the war. Toward the close of the war, however, real estate values

[2] Bureau of the Census, ***Financial Statistics of Cities: 1918.***

showed relative as well as absolute gains. With the return of millions of boys from the armed forces and the decision of many of them to look for employment in the large cities, an acute housing shortage developed. Building activity which had been checked during the war moved ahead briskly and the increase in both land and improvement values was substantial.

Present Outlook and Warnings for the Future

To what extent is this pattern duplicated today? Are the circumstances identical and can local tax experience be expected to follow a similar course? Some elements certainly, provide us with a close parallel. The severe depression preceding the present war left real estate values thoroughly deflated. Tax arrears were high and in many cities a shocking proportion of the parcels were foreclosed or abandoned. The artificial stimulus of war prosperity resulted in a marked stiffening of capital values and a rapid upturn in rentals in many cities. The current rise in prices and incomes is being followed now by better tax collections and the liquidation of arrearages. Even with rent control, price ceilings, higher federal taxes, and other anti-inflation efforts, consumer purchasing power continues to grow. The position of most taxpayers is much improved and the local tax collections reflect this upward trend in general business conditions. The limitation of building construction because of priority regulations and allocations will undoubtedly result in another postwar housing shortage. This should give rise to a construction boom, accompanied by further increases in real estate values. Moreover, returning troops and postwar migration may be expected to add increased

numbers to those residing in certain urban communities—with consequent expansion in demand for limited land areas.

In contrast to this rather encouraging, fair-weather outlook, however, there should be set down some important storm warnings concerning the financial future of American municipalities. In the first place the initial period of development and expansion of urban communities was characterized by:

1. Large-scale immigration from abroad.
2. A farm to city migration, domestically.
3. A strong nuclear growth around strategic urban centers, i.e., the building up of older cities and the rapid formation of urban centers in newly developed areas.
4. A steady growth in urban population in general, and an increase in the number of residents in each city taken individually.
5. Significant increases in the costs of local government but substantial gains in property values with consequent increases in real estate tax revenues.

Today the situation is radically different:

1. Immigration has been checked and is closely regulated by the federal government.
2. The broad movement of rural families to the cities has ceased; recent census reports reveal a stabilization of the proportion between urban and rural populations.
3. A tendency toward decentralization of our cities is clearly evident and is resulting in a breaking down of central concentration and a spreading out of metropolitan areas. Mature cities are losing population in the older settled sections and satellite communities are growing up at the periphery. As transportation is improved this tendency becomes stronger.
4. The rate of growth of urban population has declined while for individual cities there have been actual decreases in population. As the ratio between urban and rural dwellers is stabilized, the increase in numbers of residents in one city tends to come largely as a result of a shift in population from some other urban area.
5. Meanwhile, the costs of government have continued to mount and the burden of fixed or overhead costs has steadily risen—but without a corresponding increase in the property values serving as a tax base.

Other serious problems associated with property tax revenues include:

1. *Increases in tax-exempt property.* This problem, already acute in certain cities because of a liberal policy of subsidies through tax exemption, has been intensified as a result of the war. The establishment of defense housing projects, federal military zones and camps, hospitals, shipyards, war industries plants, and other fully or partially exempt properties has still further narrowed the tax base.

2. *Accumulation of publicly owned property.* Closely associated with the problem of a diminished tax base due to exemptions is the gradual reduction of privately owned parcels. Because of foreclosure proceedings against tax delinquent properties, and tax abandonment on the part of owners, substantial increases of nonrevenue land have been acquired by the cities. With the curtailment of private building construction during the war, many owners of vacant lots are voluntarily forfeiting title to the government rather than pay taxes on non-income producing properties for an indefinite period.

3. *Tax limitations.* Constitutional and statutory limits upon tax rates and on bonded indebtedness threaten to become severely restrictive during the war, particularly if price inflation results in a rise in costs of materials and services.

4. *Rent control program.* The federal control of rent levels, however necessary and important it may be as a national policy for combatting the threat of inflation, will undoubtedly discourage the expansion of the real estate tax base in those areas where the pressure of economic forces would otherwise favor a rise in rentals and in capital values.

5. *Rising local costs.* Although local tax collections are better than they have been in some years, it is also true that municipalities enjoying the best collection experiences are largely those in which expenses have mounted in like, or even greater, proportion. Increased demands for local services due to the great influx of war workers threaten to drain off any new revenues derived from rising property values. Added to this is the problem in some cities of large temporary populations living in trailers and shacks. These people pay little or nothing in local taxes but require many municipal services.

6. *Declining business.* The impact of the war has not been uniform. While it has stimulated certain activities and resulted in a boom in some areas, it has retarded others and destroyed values there. Many small business houses catering to consumer needs and unable to convert to war goods are being forced to close on account of priorities on war materials. Gasoline stations, automobile showrooms, radio supply stores, and many restaurants have been forced to close. This has lowered rentals and capital values of such properties.

7. *Tax delinquency.* Collection of tax arrears thus far has been good. However, as more men are called into the armed services, local business becomes less profitable due to the decline in consumer markets, and more firms go out of business, it is likely that tax delinquency may again become an important problem.

8. *Postwar shifts.* Readjustments following the war will involve important changes in property values and in revenues. War-boom towns will be threatened with extinction when government orders cease, while other cities will experience varying degrees of shift in land and improvement values as the industries are transformed from a war to a peacetime basis. Included in these shifts will be a repatterning of land uses not necessarily in the direction of higher land values.

While a severe cyclical drop in real estate values has been arrested and most municipalities are temporarily experiencing a perceptible improvement in tax collections, the long-term outlook for local financing is not too promising. In the older cities the combination of obsolescence, depreciation, and decentralization are causing a rapid spread of blight, accompanied by declining land values. Peripheral developments covering a larger area and resulting in magnified demands for local services will not compensate for the values lost at the centers. The vain attempts to peg assessed values of centrally located properties at artificially high levels hastens the process of decline. Moreover, there is the further possibility that new methods and materials may revolutionize the construction industry in the postwar years, particularly in terms of building costs. Any substantial reduction would have the dual effect of lowering potential assessable values for new buildings and of adversely affecting the values of old buildings. Newer cities have the advantage of a more modern, up-to-date plant which in the near future probably will suffer least from such factors as blight and overbuilding at the center. They still face some of the other problems previously mentioned, how-

ever, particularly that of preserving and maintaining their property value bases in a period of changing land-use patterns.

Conclusion

This paper began with the question of the effect of the war upon locally-collected property tax revenues. Except in those communities where the war has directly or indirectly caused a serious exodus of population and a shutting down of industry, there would seem to be only one answer. Current trends and past experience both point to the likelihood of higher, or at least stabilized, real estate tax revenues for the time being. Should the war be a long one, the added federal income and excise taxes, bond sales, and rising costs of living might result in such a heavy drain on the taxpayers' purses as to force local governments into a drastic policy of retrenchment because of lack of revenue. Even barring this eventuality, the postwar fiscal position of our cities does not appear very attractive. Economic tendencies operating before the war (and very likely to continue with increasing momentum after it) all seem to point in the direction of a slackening rate of growth in real estate values, if not a steady decline. It can no longer be assumed that local governments will have a boundless source of tax revenue in constantly rising land values. To rely for the future financial support of these cities upon a shrinking ad valorem tax base is, to say the least, unwise fiscal policy. A radical overhauling of the entire local revenue structure and a careful consideration of intergovernmental revenue relations should be a vital part of any program for postwar planning.

CHAPTER VI

EFFECT OF THE WAR ON LOCALLY-COLLECTED MISCELLANEOUS REVENUES

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Miscellaneous revenues are in a sense one of the dark continents of local government finance. No pressure groups have been organized to campaign for their reduction, as in the case of property taxes. They are not the subject of legislative debate, as is state aid. But their importance is well understood by local finance and budget officers, many of whom during the past decade have come to rely more and more on a myriad of charges, often insignificant individually which in the aggregate are now estimated to provide nearly one-fifth of all city and town revenues.[1] And they are shortly to be brought to the attention of the layman, for they—like other phases of government finance—are being affected by the war, and in the main affected adversely.

Wide Variance in Local Importance

Although they are an often neglected portion of local revenue systems, miscellaneous revenues are not lacking

[1] The Bureau of the Census estimates that in 1941 municipalities derived their governmental revenue 64.3 per cent from property taxes, 19.4 per cent from miscellaneous sources, and 16.3 per cent from fiscal aid. Cf. Bureau of the Census, *Financing Federal, State, and Local Governments: 1941.* State and Local Government Special Study No. 20 (Final), September, 1942, pp. 36 ff.

in significance. Individually they are so numerous as to defy enumeration, and there is only the loosest kind of uniformity in their designations. Some are clearly taxes, and others just as clearly are not. But whether they are imposed for regulatory purposes, or to exact payment for the granting of special privileges, or to recoup all or a part of the cost of rendering a particular service, they serve the common function of reducing a burden which would otherwise be imposed on real estate, or of financing services which otherwise could not be provided.

In some communities, because of restrictions imposed on the revenue systems by over-all tax rate limitations, miscellaneous revenues are of crucial importance in budget balancing, and in others their importance is influenced by the idiosyncrasies of the Topsy-like fund accounting systems with which many local governmental units in the United States are cursed. Other factors also operate to influence their relative importance in different communities. The fact that miscellaneous revenues average about one-fifth of all city and town revenues must not obscure the fact that individually wide variations are shown. Among the larger cities, the range is from less than 13 per cent of all revenues provided from miscellaneous sources in Pittsburgh, to more than 62 per cent in Birmingham.[2] Furthermore, the war influences which have affected and will increasingly affect miscellaneous revenue collections are by no means uniform from community to community. These factors, added together,

[2] Numerous difficulties arise in making equitable comparisons of total revenues as well as of yields of individual items on a city to city basis. For this comparison, reliance has been placed on *Property Taxation, 1941* (Bureau of the Census, State and Local Government Study No. 22, September, 1942), Table 13, showing for cities of over 100,000 population the per cent of total revenue derived from property taxes, and *Financial Statistics of Cities: 1940* (Bureau of the Census, Division of State and Local Government, Volume II, No. 1—Final).

suggest forcefully that to generalize about the effects of the war on miscellaneous revenues is extremely hazardous, and that what is said hereafter must not be strained beyond the limits of its applicability to particular situations.

State Aid Declines to Affect Mostly Counties and Schools

The item of miscellaneous revenue likely to be most spectacularly affected by the war has already been touched on in this volume, and need only be referred to here. This is the group of revenues broadly designated as state aid—subventions from the state to the localities to finance certain services, or state taxes shared by the state with the local units for the express purpose of supplementing local revenues. Counties and schools are the most important recipients of these miscellaneous revenues, gas taxes and motor vehicle fees shared with the counties being particularly noteworthy for their relation to the war. In many states gas tax and motor vehicle fee allocations are proportionate to state collections, and in these situations local reductions will be experienced automatically. Fortunately—in so far as the present situation is concerned—most of these revenues are earmarked for road and bridge or highway funds, so that the declines will not immediately affect general county financing. In a few states, as in Texas, however, gasoline taxes are used extensively for local debt service, and in these cases difficulties may be experienced if the declines are sufficiently severe.[3] Social security reimbursements

[3] The immediate consequence of a prospective decline in Texas gasoline tax collections has been the widespread use among Texas counties of refunding contracts, whereby the counties have made provision in advance to take up with refunding bonds part or all of the principal maturing during 1943 on county bonds eligible for state gasoline tax support.

and school aid, which bulk large in state-aid payments, are quite generally made from fixed appropriations or on a matching basis, so that their fate is not as dependent on the collection trends of individual state revenues. School aid, in particular, enjoys a privileged status which probably assures it considerable protection regardless of state revenue trends.

Local Charges Based on Motor Vehicle Use Declining

Turning to the locally-collected miscellaneous revenues themselves, a wide variety of results are evident. To date, the revenues being adversely affected by war influences appear to fall into two broad categories: first, those based on the use of motor vehicles, which like state-collected gasoline taxes and motor vehicle charges are being reduced by mileage restrictions and tire and gasoline rationing; and second, those charges levied against individuals and business concerns, which are being reduced because of curtailed or liquidated operations resulting from the draft, shortages of materials and consumers' goods, and other restrictions on normal civilian activities. These are largely revenues accruing to cities, although there are in some counties local collections falling in the first group.

Examples of local charges based on motor vehicle use include auto inspection fees, filling station and garage licenses, traffic court fines and costs, and parking meter receipts. Some of these revenues generally account for only a negligible proportion of the total revenues of individual units, but many of them are due for rather spectacular declines. For example, gasoline station inspection fees in Oklahoma City for the fiscal year ended

June 30, 1942, were 28 per cent below those collected for 1940-41,[4] while in Denver auto ownership tax collections for the first six months of 1942 were 9 per cent below those for the same 1941 period.

Parking meter receipts are in general expected to show a mixed trend, the local showing being dependent in large measure on the presence or absence of a local war boom which might be counted on to produce sufficient new traffic to offset reductions in the normal volume of motor vehicle use. The expectation is not being uniformly realized, however. Galveston, with large scale military establishments in its vicinity and some war work, showed a 14 per cent increase in parking meter receipts for the year ended June 30, 1942, but Long Beach, California—a community authoritatively stated to have been more affected during the past ten or twelve months by accelerating war production than any other southern California community—had in 1941-42 parking meter receipts virtually unchanged from those of 1940-41.

Business and Occupation Licenses Already Falling

Of more serious effect on local budgets will be declines in miscellaneous revenues based on charges against business and professional activity. Some of these charges play a very minor part in financing local government, and sharp declines will be relatively unimportant for these items, but the group as a whole accounts in many units for a large part of locally-collected miscellaneous revenues and in some cities individual charges of this type are of the utmost importance. Denver's experience

[4] This and later data on individual cities are based on the annual, semi-annual, or monthly reports of the chief fiscal officers of the municipalities concerned.

for the first half of 1942 illustrates the trend. Here, revenues from licenses and permits through June 30, 1942, were 18 per cent below those of the first half of 1941. Also illustrative is Kansas City, Kansas, where less than 15 per cent of all revenues come from miscellaneous sources but one-third of the miscellaneous category comes from occupation licenses. For the first six months of 1942, Kansas City's occupation license revenue was 5 per cent below that of the first half of 1941. And from Chicago comes a very striking forecast of what may develop. As of October 31, 1942, there were licensed in Chicago 8,347 saloons, but according to reports only 6,635 applications for renewals had been received up to the deadline for filing renewals. City officials estimate that after late applications have been tabulated, about 1,000 fewer licenses will have been issued for the new period, entailing a revenue loss to Chicago of around $800,000. Last year liquor licenses in the aggregate accounted for 13 per cent of Chicago's general purpose fund revenues, and under existing limitations on the city's revenue system the loss of $800,000 will be a serious one.

Further light on the recent and prospective trend of business and occupation license collections is afforded by recent surveys of business births and deaths. These indicate that by the end of the year there will have been a net decline of about 300,000 in the number of business establishments in the nation. Significantly, this decline is not so much the result of the closing up of existing establishments—except for a few lines, such as gasoline filling stations, the volume of business deaths is virtually unchanged—as it is of the fact that new businesses are not being created in normal volume. The situation is

important for local budget makers, since it indicates a more general decline in charges based on business enterprises than might otherwise be supposed. There has been, for example, a supposition that in war-boom communities the mushrooming of new establishments, especially service establishments, would more than offset closures caused by the drafting of proprietors, etc. Test checks indicate, however, that this is by no means uniformly true, and that even cities temporarily enjoying boom conditions may show a decline in the number of establishments subject to business and occupation licenses and permits.[5]

The foregoing comment will, of course, not apply to those communities of a few hundred people where facilities to care for thouands have been erected overnight, but it indicates what may be expected in the larger communities. To refer again to Long Beach, that city showed for 1941-42 a 9 per cent decline in business and professional licenses, and this despite the tremendous war plant expansion there and the addition of thousands of new workers and residents in the city and immediate vicinity. On the other hand, Wheeling, West Virginia, also a war-boom city, showed a 31 per cent increase in business and occupation license collections for the year ended June 30, 1942.

Some Miscellaneous Revenues Increasing

On the other side of the ledger, there are some miscel-

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[5] The estimate of a 300,000 decline in number of business establishments is attributed to the Murray Small Business Committee. For details on the trend, reference is made to numerous special surveys of the Research and Statistical Division, Dun & Bradstreet, Inc., New York City. Cf. especially, "Births and Deaths in Business," by Walter Mitchell, Jr., Director of Survey, and William Hayes, in *Dun's Review*, November, 1942, pp. 16 ff.

laneous revenues which may be expected to show increases, at least in a number of communities. Philadelphia, whose municipal income tax revenue through October 31, 1942, was 25 per cent ahead of the first 10 months of last year, is currently the envy of virtually every large city, and the few cities retaining municipal sales taxes in some shape are also experiencing, at least temporarily, an increase in revenue from this source. For the majority of cities, however, the greatest likelihood of increased miscellaneous revenues comes from the service charges. Oklahoma City, for example, showed a 5 per cent increase in its important garbage collection fee revenue for the fiscal year ended June 30, 1942, and in Corpus Christi, Texas, sewer service charges for 1942-43 were nearly 20 per cent greater than in the preceding year.

Increases are also prospective in those instances where cities apply to general operating purposes the profits of public service enterprises. Gross revenues of municipal water and electric power systems have increased generally during the past year, and in some communities, especially affected by war production, very sharp increases have been shown, with operating costs not up in proportion and the federal income taxes which are curtailing privately owned utility earnings lacking in the case of municipal plants. Not all cities with public service enterprises are free to apply utility profits to general purposes and not all free to do so chose to make this diversion. In many instances, moreover, new financing or the application of current funds have been necessary to make additions to the system, so that the added gross revenue is not always clear gain.

Some cities, however, are in a position to utilize utility profits for general purposes. Jacksonville, Florida, for example, has in the past derived as much as one-third of its total revenue from utility surplus, and in Long Beach, California, surplus of the water and gas departments accounted last year for roundly 17 per cent of all general purpose revenues. Long Beach has increased the gas department's contribution to the general fund from a few hundred thousand dollars a year to $650,000 in 1940-41 and $750,000 for 1941-42, with every indication that still larger diversions can be made next year without jeopardizing the utility's position.

Long Beach is also illustrative of one of various special miscellaneous revenues which are not common but may be of great local importance. The city is the fortunate owner, through its harbor department, of oil bearing lands, from which it realized last year nearly $2,500,000 in royalties, appropriated under charter provisions, half to pay harbor bonds and interest and half to finance harbor operations and improvements. Several other cities, among them Tulsa and Oklahoma City, also receive oil royalties, but here depletion of oil reserves has been operating to reduce revenues, and the war has not to date served to reverse the trend.

New Charges May Be Anticipated to Offset Declines

As the war progresses, and declines in miscellaneous revenues become more pronounced, it is not unlikely that we will see efforts on the part of local authorities to increase the aggregate yields by imposing new charges. There has been a trend for some years, for instance, toward the wider use of garbage collection and sewer

service charges, and additional cities may be expected to impose them if they are able. Suggestions have also been made that pressing revenue problems of some of the war-boom communities might be temporarily solved by the imposition of sales or payroll taxes. As temporary expedients such devices might be justified on the grounds that they would readily reach many persons receiving but not at present paying for city services, although their retention after the emergency has passed would only complicate the already over-complicated pattern of federal-state-local fiscal relationships.

Cities attempting to increase miscellaneous revenue yields may be faced with unexpected difficulties, however. Recent reports are that a proposed increase in its garbage collection charge by Berkeley was disallowed by the regional office of the OPA, and a proposal of San Diego to collect a tax of ten cents a day on each house trailer in the city was similarly vetoed. If the federal government is able to prevent service charge increases and other adjustments to miscellaneous revenues under the guise of price fixing, one of the simplest solutions for many local units may be eliminated.[6]

Probably, in practice, substitute miscellaneous revenues will not prove as much a solution to declines as will realistic budgeting. Many local budgets for 1942 showed surprising grasp on the part of local officials of the uncertainties facing local government, and 1942-43 budgets now beginning to appear seem in many instances to be following the same pattern. Where budgets can be drawn to anticipate reasonable declines in miscellaneous revenues and to provide adequate reserves for contin-

[6] Municipal Finance Officers Association of the United States and Canada, *News Letter*, October, 1942, p. 6.

gencies, little difficulty is to be anticipated, even in the face of fairly substantial declines in individual miscellaneous revenues.

In conclusion, it must be emphasized again that the prospective declines in miscellaneous revenues will not fall with equal impact on each local government unit. Often, cities and counties will be able to absorb without disaster fairly sharp drops in their shares of state-collected gasoline taxes and motor vehicle revenues, whereas relatively minor declines percentage-wise in miscellaneous revenues going into the general fund may necessitate extensive expenditure adjustments or the imposition of new charges, this being especially true in limited-tax situations where the recent level of expenditures has been maintained only by scraping up every nickel available from miscellaneous sources. Where the local revenue system leaves the city free to utilize the property tax as the flexible factor in budget balancing, however, miscellaneous revenue declines will probably cause only limited difficulties.

PART THREE

INTERGOVERNMENTAL FISCAL PROBLEMS AS ACCENTUATED BY WAR

CHAPTER VII

INTERGOVERNMENTAL TAX EXEMPTIONS

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The economic and legal aspects of intergovernmental tax exemptions are very broad and complicated, but the problems come more or less to a focus in a few of the issues that are causing most concern at the present time. Chief among these are the restrictions on local taxation of federal property, the recent attempts to immunize war contracts from state and local sales and use taxes, and the efforts that have been made to abolish the federal tax immunity of interest on state and local bonds.

The existence of various types of intergovernmental exemptions has long been a source of irritation and confusion, but the situation has become acute—particularly from the standpoint of state and local government—since the initiation of our war production program in 1941. Although state and local revenues have held up very well, and a number of states now enjoy a revenue surplus, it seems quite probable that there will be a sharp curtailment in state and local tax bases within the next six months. The problem is aggravated by the need for increased governmental services and expenditures growing out of the concentration of population in areas where there are large war plants, defense housing projects, army camps, naval stations, shipyards, etc. It is under conditions such as these that strong efforts are being

made to tinker with this aspect of intergovernmental relationships. Although the agitation for change appears to have subsided temporarily, it is of a chronic nature and may, therefore, be expected to break out from time to time. Let us turn now to a consideration of the three chief issues.

Taxation of Federally Owned Real Estate

By judicial interpretation of the federal Constitution, state and local governments may not tax property of the federal government unless authorized specifically by Congress to do so.[1] Thus, no matter how reasonable or non-discriminatory it might be, a local or state tax cannot be applied to federal property or instrumentalities without the consent of Congress. Federal real estate holdings, prior to World War II, were large and constituted a fairly substantial part of total tax-exempt property. In a report of a special committee of the National Emergency Council a few years ago, it was shown that, as of June 30, 1937, state and local governments would have received approximately $91,000,000 in taxes annually if federal real estate had been taxed at an average tax rate of $27.73 per one thousand dollars.[2] The assessed valuation of federal property was estimated at $3,300,000,000, which was about equally divided between land and improvements. Compared with the grand total

[1] *McCulloch* v. *Maryland*, 4 Wheat. 316 (1819); *Weston* v. *The City Council of Charleston*, 2 Peters 449 (1829), 27 U. S. 448; *Van Brocklin* v. *State of Tennessee*, 117 U. S. 151 (1886); *First National Bank* v. *Anderson*, 269 U. S. 341 (1926). In the *Van Brocklin* case the court stated: "Whether the property of the United States shall be taxed under the laws of a State depends upon the will of its owner, the United States, and no state can tax the property of the United States without their consent."

[2] *Report of Committee on Federal Ownership of Real Estate and Its Bearing on State and Local Taxation*, 76th Congress, 1st Session, House Document No. 111, Appendix A, No. 1.

assessed valuation of $113,000,000,000 for the entire country, federal holdings constituted about 3 per cent. The report also disclosed that "the government owns more than 20 per cent of all land in the United States." Using the figure of $3,300,000,000, Pond has estimated that federal holdings in 1937 represented 16.3 per cent of exempt real estate in the United States.[3] Although figures are not available for a comparison of federal holdings in 1942 with those for 1937, it is obvious that the great expansion in federal ownership during the past year and a half would raise the figures for assessed valuations and taxes far in excess of those estimated for 1937.

Shared Revenues and In-Lieu Payments

It should not be inferred from the preceding remarks that no federal property is subject to state and local property taxes. As a matter of fact, the real property of a number of government corporations is now subject by federal statute to local taxes in the same manner as other real property. Among these are the Reconstruction Finance Corporation, Home Owners Loan Corporation, Federal Savings and Loan Insurance Corporation, Federal Deposit Insurance Corporation, Federal Farm Mortgage Corporation, Production Credit Corporation, etc.

In addition there are federal statutes which authorize payments to states by governmental agencies performing certain activities that produce revenue. Under this arrangement, two alternative types of payment are found.

[3] C. B. Pond, "The Value and Importance of Exempt Real Estate in the United States," *Taxes, The Tax Magazine*, XVIII (July, 1940), 422. According to Pond's estimate, state and local holdings were 46.2 per cent and private holdings were 37.5 per cent of total exempt real estate.

One involves the sharing with the states of a certain percentage of the revenue obtained from the sale or lease of public lands. Illustrative of this type are (1) the Five Per Cent Public Land Funds Act (*U. S. Code,* 1940, Title 31, sec. 11) providing that 5 per cent of the net proceeds of sales of public land in Florida, Iowa, Michigan, Minnesota, Missouri, Nevada, Oregon, and Wisconsin shall be paid to these states to be used for education or public roads; and (2) the Mineral Leasing Act of February 25, 1920 (*U. S. Code,* 1940, Title 30, sec. 191) providing that 37½ per cent of the funds derived from bonuses, royalties, and rentals under this act shall be paid to the state within which the leased lands or deposits are located for the use of public roads, support of the public schools or other educational institutions.

The second type represents the payments which are made to the states or municipalities in lieu of taxes. This kind of arrangement is illustrated by the following: (1) A federal statute of 1936 (*U. S. Code,* Title 40, secs. 421-23) relative to slum-clearance and low-cost housing projects, authorized the Administrator of Public Works to enter into agreements with the states and their subdivisions for payments in lieu of taxes, the amounts of which were based upon the cost of the local governmental service to be furnished for the benefit of the projects or persons residing therein, but taking into consideration also the benefits to be derived from the projects by the particular state or subdivision involved. (2) Another federal law of 1936 (*U. S. Code,* Title 40, secs. 431-32) authorized the United States Department of Agriculture to make payments to states and local units for resettlement and rural rehabilitation projects similar to those made for slum-clearance and low-cost housing projects.

(3) An act of 1937 (*U. S. Code,* Title 42, secs. 1409-13) authorized the United States Housing Authority in the United States Department of the Interior to make payments to states and their subdivisions for the elimination of slums and unsafe and insanitary housing facilities, subject to the limitation, however, that such payments should not exceed the taxes which would be levied against the property if it were taxable. Finally, (4) the Tennessee Valley Authority makes substantial payments in lieu of taxes in the six states in which it owns property, which, as a result of the Norris-Sparkman amendment to the Tennessee Valley Authority Act, are expected to replace practically all of the taxes formerly collected by the state and local governments.[4]

In the past, the payments made by the federal government in lieu of taxes have not been sufficient to cover the costs of servicing the properties involved.[5] The Federal Public Housing Administration is now taking steps to liberalize and equalize such payments, however,[6] and it is expected that they will be raised to the equivalent of local taxes on similar properties in private ownership. It should be pointed out, though, that this is not a full solution to the problem. In some communities, such as Willow Run, Michigan, the increase in population, and the accompanying demand for additional governmental services, has been so great that the federal government will have to provide not only for greater in-lieu payments but also for larger grants-in-aid for the construction and opera-

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[4] Alexander F. Edelmann, "Public Ownership and Tax Replacement by the T. V. A.," *American Political Science Review,* XXXV (August, 1941), 737.

[5] Thomas H. Reed, "Short Rations for Local Government," *National Municipal Review,* XXXI (September, 1942), 427.

[6] Municipal Finance Officers Association, *Municipal Finance News Letter,* May 16, 1942, p. 1; September, 1942, p. 2.

tion of "community facilities" of the type provided in the Lanham Act (Public Act No. 849, 76th Congress, October 14, 1940).

Taxes and Exemptions for War Plants

In many communities the rapid expansion in industrial, military, and naval facilities has been accompanied by an increase in the amount of tax-exempt property. If such facilities are built for direct ownership by the Army, Navy, or Maritime Commission, they are exempt entirely from state and local property taxes, both real and personal. More than three-fifths of government financed facilities are of this type, according to a recent study.[7]

Another type of publicly owned war plant is that which is financed by subsidiaries of the Reconstruction Finance Corporation, such as the Defense Plant Corporation, Defense Supplies Corporation, Metals Reserve Company, and the Rubber Reserve Company. These plants, which are owned by the government corporation, are leased to the manufacturer with an option to purchase at the end of a certain period. In the Reconstruction Finance Corporation Act, as amended, Congress authorized the states and their local subdivisions to tax the real estate of the RFC and its subsidiaries, although their personal property is not taxable. Under this arrangement, the inventory of war plants is exempt, and also the machinery if it is owned by the federal government. The same rules apply to contractors engaged in the construction of war projects on a cost-plus-a-fixed-fee basis. Both the real and personal property of lump-sum contractors are tax-

[7] Carl W. Tiller and Margorie Leonard, "Decrease of the Property Tax Base Due to Exemptions," *Municipal Finance*, XIV (May, 1942), 36.

able. Exemption of the personal property of war plants financed by the RFC or its subsidiaries created a difficult situation in Michigan, and perhaps in other states, because of a state law which requires that buildings located on leased land shall be assessed as personal property. It was primarily to deal with this situation that Congress amended the Reconstruction Finance Corporation Act to provide that "such exemptions shall not be construed to be applicable in any State to any buildings which are considered by the laws of such State to be personal property for taxation purposes."[8]

The importance of this type of exemption may be illustrated by reference to Michigan where the tax on personal property in several cities ranges from 20 to 25 per cent of the total property tax levy, and in the state as a whole this ratio was 25 per cent for the year 1940. For the entire country, the ratio of personal property taxes to the total of real and personal property taxes usually falls within the range of one-third to one-tenth, although there are of course wide variations.[9] Probably the actual tax loss from the exemption of personal property has not been large because of the tendency for real estate valuations to rise, but it is likely to become more serious with the continued decline in peacetime production and merchandising and the rise in war production.

Another type of exemption that has caused difficulty in a number of cities from Connecticut to California is that which is granted to property owned by foreign governments. Although the exchange of notes in Janu-

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[8] "Federal Chiseling at Local Tax Base Hit," *Michigan Municipal Review*, XV (January, 1942), 3. *See also* International City Managers' Association, *The Municipal Year Book*, 1942, p. 211.

[9] George W. Mitchell, "Future of the Property Tax as a Source of Revenue in American Cities," *Municipal Finance*, XIV (May, 1942), 21.

ary, 1942, between the British and American governments recognized mutual immunity only from the personal property tax, the American Department of State pointed out that real property owned by foreign governments and used for governmental purposes is exempt in the District of Columbia and it "hinted" that a similar exemption should be granted by the states.[10] The significance of this exemption to various localities can be indicated by reference to Detroit. Judging from the newspaper stories that have appeared, it is not a military secret that the Packard Motor Car Company is producing certain war materials for the British government, and as a result more than $5,500,000, involving taxes of $152,000, has been removed from the tax rolls. Naturally there are many in Detroit who feel that an exemption of this sort places an undue burden on taxpayers in that area.

A description of the various types of exemptions applicable to federally owned property indicates that the problem is especially serious in areas where war production is concentrated. This is true because these areas have experienced a sharp increase in population, which, of course, has increased the demand for ordinary governmental services relative to health, sanitation, education, recreation, and fire and police protection. The situation is particularly acute in some of the rural communities within metropolitan areas, where the establishment of a large war plant has virtually created a new urban community in a rural township, which is utterly incapable of furnishing the very minimum of governmental services. Several outstanding illustrations of the tendency to locate war plants beyond incorporated limits

[10] Tiller and Leonard, *op. cit.*, p. 36.

are found in Michigan. The world's largest bomber plant, which overlaps the boundaries of three townships, has been established at Willow Run about twenty-five miles west of Detroit. In Warren Township which borders Detroit on the north, although it is in a different county, are located two other large plants, the Hudson Naval Arsenal and the Chrysler Tank Plant. Township government in these communities is unable to cope with the problem and already housing, sanitation, and school conditions have become serious. With a large amount of the property of such plants being exempt from property tax, it can be seen that local government in those areas will have to turn elsewhere for funds.

War Contracts and State Sales Taxes

Turning now to the field of state taxes, a confusing situation existed during the early stages of our defense program regarding the applicability of state sales taxes to independent contractors engaged in the performance of government contracts, such as the building of army camps, etc. In November, 1941, however, the situation was clarified by two important decisions of the United States Supreme Court. One case (*Alabama* v. *King and Boozer,* 314 U. S. 1) involved the application of the Alabama sales tax to materials purchased in Alabama by a contractor operating on a cost-plus-a-fixed-fee contract, while the other (*Curry* v. *United States,* 314 U. S. 14) involved the question of whether the purchase of materials outside that state by such a contractor was subject to the state use tax. Although the cost-plus contracts usually contain the provision that the federal government will reimburse contractors for state and

local taxes, there is also another standard provision that the contractors shall make all transactions in their own name and not "purport" to bind the government. It is unnecessary here to analyze these two cases separately and it will suffice to say that in general the Court upheld the application of the sales and use taxes to transactions of this type on the grounds that the contractors were not agents or instrumentalities of the government and were, therefore, not immune from taxation, despite the fact that the burden of the taxes would be shifted to the government through the operation of the contracts. These two cases indicate that the Supreme Court has apparently adopted the theory of "legal incidence" for sales to cost-plus-a-fixed-fee contractors in that the non-discriminatory tax is paid by the contractor even though the money burden falls ultimately upon the government.

In a third case decided in November, 1941, the United States Supreme Court held that Congress had the authority to grant immunity from state taxation to a governmental agency, and it therefore invalidated an attempt to impose the North Dakota sales tax on transactions involving a federal land bank.[11] Thus it appears that Congress has considerable latitude in its authority to grant tax immunity to federal agencies and instrumentalities. But the question of whether or not a Congressional grant of tax immunity would be upheld after the Supreme Court had previously denied immunity on an implied constitutional basis (as in the *Curry* and *King and*

[11] *Federal Land Bank of St. Paul v. Birmarck Lumber Co.*, 314 U. S. 95. In the Curry case the Court also stated that "the Constitution, without implementation by Congressional legislation, does not prohibit a tax upon Government contractors because its burden is passed on economically by the terms of the contract. . . ."

Boozer cases) has not been carried to the court.[12] This issue would arise, however, if Congress should enact the proposal, which has been introduced several times in the present year, to exempt cost-plus contractors from state sales taxes. If faced with this issue it seems likely that the Court would sustain the legislation if Congress stated that tax immunity for federal contractors was essential to the war effort. Let us turn now to a consideration of some of the fiscal implications of a Congressional grant of tax immunity to cost-plus-a-fixed-fee contractors.

Only a few days after the Supreme Court handed down the decisions in the cases affecting the Alabama sales and use taxes, a bill was introduced in Congress by Representative Cochran of Missouri to exempt from state and local taxation "the sale, purchase, storage, use, or consumption of tangible personal property for use in performing defense contracts." It would have applied to both cost-plus and lump-sum contracts. Although this particular bill received very little support, a number of substitutes were introduced at various times, the latest version of which is House Resolution 6955.[13] This bill was referred to the Ways and Means Committee on April 20, 1942, and apparently no further action has been taken on it.

In discussing the original measure in February, 1942, Representative Cochran stated that if immunity were not granted for contracts under Army and Navy appropriations pending in Congress at that time, the sales taxes

[12] Douglas H. Eldridge, "War . . . and State Sales Taxes," *Taxes, The Tax Magazine*, XX (July, 1942), 413.

[13] The original bill was H. R. 6049; substitutes were H. R. 6617, H. R. 6750, and H. R. 6955. *See* Dixwell L. Pierce, "Should War Contractors and Their Vendors Be Immune from State Taxes?" *Bulletin of the National Tax Association*, XXVII (May, 1942), 244-52.

which would have to be paid would cost the federal government $1,500,000,000. Statements of this sort indicate quite clearly the general tendency to overlook the fiscal needs of state and local government. But looking at these figures from another angle, it might be said that the sales tax exemption would cost state and local government about $1,500,000,000. And therein lies the real question: Should an extension be made in the immunity doctrine in order to reduce federal costs but which would at the same time cause a serious reduction in state revenue? This is an oversimplification of the issue, for back of it are two important considerations: (1) the possibility of a serious decline in state and local tax revenues within the near future; and (2) the great demand for additional governmental services and expenditures as a result of the increased concentration of population in areas directly affected by the war production and training programs. Incidentally these are the areas that would be most affected by the exemption.

In view of these conditions it would seem that no action of this sort should be taken which would create another serious threat to state and local revenues. There are many who are of the opinion that, by the end of the present fiscal year, the outlook for state and local revenues will not be a favorable one. Furthermore, the indications are that federal assistance to the states will decline, and it is highly improbable that there would be any compensatory grants from the federal government to offset the loss in revenue from this exemption. With the steady encroachment of the federal government on the field of state taxation it would seem undesirable to substitute compensatory grants for this type of taxation.

State and Local Bond Immunity

In the last few years several attempts have been made in Congress to subject future issues of state and municipal bonds to the federal income tax. Such measures were defeated in 1940 and 1942.

What issues are involved in this controversy? The Treasury favors removal of the exemption primarily on the grounds that it is an important avenue of tax avoidance for persons with large incomes, that it produces sharp inequalities in tax burdens, and that it would bring in additional revenue.[14] Opposed to the removal of this exemption are the Conference on State Defense, the various organizations of local officials, as well as the National Education Association, the American Bar Association,[15] and the American Federation of Labor. It is the contention of those who support the present exemption, that the tax avoidance argument is greatly exaggerated as indicated by the fact that a relatively small proportion of state and municipal securities are owned by wealthy persons, that it would increase the cost of local financing substantially,[16] and finally that it endangers the sovereignty of the states, for without adequate financial power and integrity there can be no real sovereignty. Great emphasis is placed upon this last point as

[14] Secretary Morgenthau stated that taxing the interest of future and outstanding issues would yield $200,000,000 a year. U. S. House of Representatives, Committee on Ways and Means, *Hearings on Revenue Revision of 1942*, Revised, Vol. I, p. 8.

[15] The position of the American Bar Association is that the federal government could exercise this power validly only by a constitutional amendment. Statement of Austin J. Tobin, *op. cit., Revenue Revision of 1942*, Vol. 2, p. 1486.

[16] Professor H. L. Lutz estimated the annual increase of interest caused by an additional 90 points in the cost of local borrowing at $174,000,000. *Op. cit., Revenue Revision of 1942*, Vol. 2, p. 1507.

indicated by the statement of Mr. Austin J. Tobin before the House Ways and Means Committee in which he said:

> Much of the misunderstanding of this proposal arises because the Treasury discusses it simply as a problem in taxation or in alleged tax evasion. But this is not a problem in abstract economics. The answer is not to be found by adding up possible Federal tax revenues on the one hand, increased interests to local government on the other, and then subtracting the two totals. The real nature of this problem is one of the preservation of independent local government, of the continuance of true federalism under our Constitution. It is a problem that reaches into the very nature and qualities of the democratic process itself.[17]

Mr. Randolph Paul of the United States Treasury Department in replying to this argument stated that the removal of the exemption would not "give the federal government the power to levy special or discriminatory taxes upon any or all operations of state and local governments. . . . The elimination of tax exemption would not give the federal government the right to tax state and local interest at rates any higher than apply to other forms of income. It would give the federal government no new powers over the operations of state and local governments."[18]

Nevertheless, there is widespread apprehension over this proposed extension of federal powers. This particular exemption is one of the important symbols of our dual form of government and its removal would be regarded by many as a "body blow" at municipal credit. Although the measure which was defeated in October, 1942, provided only for the taxation of future issues, it is significant that Secretary Morgenthau, in his statement before the House Ways and Means Committee on March 3, 1942, advocated not only the taxation of income from future

[17] *Ibid.*, p. 1482.
[18] *Ibid.*, Vol. 3, p. 3082.

issues of state and local bonds, but from outstanding issues as well.[19] There seems to be little doubt that such a step would have an extremely demoralizing effect on municipal finance. Furthermore, it would constitute a breach of good faith for these bonds were purchased on a tax-free basis.

Various statistical studies have been made of the fiscal effects of subjecting the interest on state and local bonds to federal income tax. One of the first steps in such an analysis is to compare the rate of yield on tax-free municipal bonds with that on taxable bonds of private business corporations bearing approximately the same degree of risk. A study by Professor Lutz shows that the differential in yield between municipal bonds and the average yield of industrial and public utility bonds was 73 basis points in 1940 and 103 basis points in 1941, as compared with an average of 66 basis points, or sixty-six hundredths of one per cent, for the years 1937 to 1939.[20] Obviously, if the interest on municipal bonds became subject to federal income tax, this differential would be narrowed, and the yield on municipals before deducting the tax would approach that of private bonds of comparable rating. Municipalities would have to pay a higher rate of interest on their bonds or the price of municipals might decline with the rate of interest remaining unchanged; but in either event the net yield after deducting the tax would be approximately the same as at present.

On the basis of the above differentials from 1937 to 1941 Lutz concluded that 90 points, or nine-tenths of one

[19] *Ibid.*, Vol. 1, p. 8.

[20] *Ibid.*, Vol. 2, p. 1505. This rise in the average yield differential between private and municipal bonds of comparable rating reflects the effects of rising taxes during those years.

per cent, would be a conservative estimate of the increased cost of borrowing by municipalities through removal of the tax exemption. Thus, the additional interest cost involved in carrying a total taxable debt equal to the total $19,300,000,000 of state and local debt outstanding on June 30, 1940, would be $174,000,000.[21] Of course, if only future issues were made taxable, such an increase in annual costs would occur only after a period of forty to fifty years. But by the same token the increase in federal revenue would come about only gradually as refunding or new bonds were issued.[22] In this connection, Mr. Randolph Paul has stated:

> In recent years new and refunding state and local issues have averaged about $1,000,000,000 annually. If this volume should continue, the immediate effect of the elimination of the tax immunity would be an increase in state and local interest costs of about $5,000,000 during the first year. Eventually, the annual difference would reach about $100,000,000 if the debt of state and local governments remained at its present level.
> The net cost to state and local governments would be less than $100,000,000 since they would obtain increased revenues from the application of their income taxes to new Federal issues, if Congress consents to such taxation.[23]

Having considered the increased cost to municipalities there remains the question as to how much federal revenues would increase. Mr. Paul estimated that the annual loss in revenue from exempting state and local securities, at 1941 rates, would be about $184,000,000; and at "rates

[21] *Ibid.*, p. 1507.

[22] The yield of the proposal, which was defeated in the Senate on October 8, 1942, to tax only future issues was estimated at $15,000,000. *The New York Times*, October 9, 1942, p. 12.

[23] *Op. cit.*, *Revenue Revision of 1942*, Vol. 3, p. 3083. Mr. Paul's figure of $100,000,000, as compared with Professor Lutz's estimate of $174,000,000, involved the assumption that "the tax exemption privilege would increase interest rates on new state and local issues by something less than one-half of one per cent on the average."

proposed by the Treasury'' for the 1942 Revenue Act his estimate was $275,000,000.[24] On the other hand, Professor Lutz estimated that the federal revenue yield from this source at 1941 tax rates would be $176,000,000, which was only slightly higher than his estimate of the increase in borrowing costs to municipalities. In other words, according to Lutz, removal of the exemption would ''increase local taxation by about as much as it increases the Federal revenue.''[25]

There are probably none who will deny the contention of the Treasury that the hypothetical federal revenue loss from this source will probably rise during the war. But from both the absolute and relative standpoints, this loss to the federal government would be infinitesimal. On the other hand, the increased costs falling upon local government would be significant, and particularly to a number of cities that are now planning refunding operations. The increase in local costs, which would follow abolition of the immunity, would obviously have to be borne by property taxpayers and by consumers of municipally owned utilities to the extent that these utilities are financed by borrowing. Thus the real effect of such action would fall not on bondholders but on local property taxpayers and rate payers. With the outlook for municipal finance within the near future being one of decreasing revenues and increasing expenditures especially in defense areas, no extended argument is required to show that the present is not an auspicious time for adopting a measure of this sort.

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[24] *Ibid.*, p. 3079.
[25] *Ibid.*, Vol. 2, p. 1509.

Conclusion

The question might well be raised in conclusion as to whether existing arrangements relative to exemptions and immunity of the type discussed here represent a logical policy. Is Congress consistent in declining to pass legislation (1) to remove the implied constitutional immunity of state and local securities from federal taxation, and (2) to immunize from state taxation contractors operating under cost-plus-a-fixed-fee contracts for the construction of governmental projects? It would seem that its position on these two issues is not contradictory.

From a legal standpoint there is no parallel relationship between the independent contractor cases and the immunity of state and local securities. In the case of *James* v. *Dravo Contracting Co.* (302 U. S. 134) which was cited with definite approval in the *King and Boozer* case, the Supreme Court stated that these two situations were clearly distinguishable. The language of the Court was as follows:

> There is no ineluctable logic which makes the doctrine of immunity with respect to Government bonds applicable to the earnings of an independent contractor rendering services to the Government. That doctrine recognizes the direct effect of a tax which "would operate on the power to borrow before it is exercised . . ." and which would directly affect the Government's obligations as a continuing security. Vital considerations are there involved respecting the permanent relations of the Government to investors in its securities and its ability to maintain its credit,—considerations which are not found in connection with contracts made from time to time for the services of independent contractors. (302 U. S. 152.)

From a fiscal standpoint, the exemption of contractors from sales taxes would have the effect of decreasing federal expenditures but at the same time it would decrease state revenues; and removal of the tax immun-

ity for state and local securities would increase federal revenues but also increase local costs. Although federal, state, and local governments are all faced with the problem of obtaining sufficient revenues during the war, both of these proposals strike at two of the chief tax sources of state and local government. The argument that these two changes are essential to the war effort is not convincing in view of the alternative revenue sources available to the federal government, but which are closed for all practical purposes to the states and local units. Indeed, the war effort argument might also be used to justify the imposition of the local property tax on federal real estate and on the personal property of cost-plus contractors. Although federal expenditures now completely overshadow those of all other governmental units, the fact should not be overlooked that the states and local units are also participating in the war program. Expenditures for civilian defense and for the expansion of local service facilities, such as fire and police protection, sanitation, health, and schools, have been large and they may even become larger as the war continues. The federal government has provided some financial assistance for these purposes, but a substantial part of the costs must be borne by the local areas.

There seems to be general agreement that state and local government will be faced with a serious revenue problem in the near future, and it would seem to be quite clear that their difficulties should not be multiplied by the adoption of unnecessary measures. The gain to the federal government from the two proposals considered here would be relatively insignificant as compared with the loss to state and local government. Furthermore, the temporary advantage of some additional federal

revenue should not be allowed to overcloud the more fundamental issue of the impairment of state sovereignty. When changes of this sort are to be considered, let it be during a period of peace and then only as part of a comprehensive re-examination of the administrative and tax relationships of federal, state, and local government.

CHAPTER VIII

BOND EXEMPTION—AN UNJUSTIFIED SUBSIDY TO STATE AND LOCAL BORROWING

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The federal Treasury has recently estimated that the exemption of interest on state and municipal bonds from federal income taxation has been responsible for a loss of federal revenue of $190,000,000 a year under the 1940-1941 tax rates, and will be inflicting upon it a loss of $275,000,000 of revenue annually under the higher rates of the 1942 Revenue Act. The loss of so large an amount of revenue, at a time when additional funds are badly needed by the government to finance the war effort, is a very serious matter. But even more serious is the fact that this situation makes possible the avoidance by the wealthy taxpayers of their due obligations to the government. The fact that this avoidance exists and that it assumes such huge dimensions undermines the confidence of the public in the justice and integrity of our tax system, thereby making it more difficult for our government to raise the additional sums required by it at this time. Needless to say, such undermining of the public confidence in the equity of our tax system is particularly dangerous in a time of war, when the burdens of taxation must necessarily be heavy and when their equitable distribution among the citizens is, therefore, of special importance. It is evident, therefore, that the exemption

in question has adverse social, ethical, political, and indirect financial effects which by far transcend in importance their immediately discernible direct adverse financial effects.

1939 Proposal to Abolish Exemption on Future Issues

In a comprehensive report submitted to Congress in 1939, the Treasury, with the full support of the President, recommended to Congress the termination of the exemption on all future state and municipal issues. It did not at the time, however, raise the question as to whether the exemption should also be terminated on the outstanding bonds, recognizing apparently its more complicated character and not wishing to make an already difficult undertaking still more difficult. The Treasury was willing, apparently, to limit its proposal to the future bond issues, even though thereby it would be postponing the final and complete extinguishment of the exemption for a period of forty years or so which will have to elapse before all the existing issues are either retired or refunded.

Although the Treasury's proposal did not disturb any existing equities of the bondholders and was thus extremely reasonable and moderate, it met with a storm of opposition from state and municipal officials. The latter did not wish to give up for their communities the slight advantage which the exemption has been giving them in the flotation of their bonds. Moreover, rather fancifully, the officials regarded the Treasury's proposal as being an attack on the fiscal independence of their governments. They were supported in this opposition by pressure organizations allied with propertied interests which had

never favored the application of such highly progressive rates of taxation as have recently been brought into vogue, and which, consequently, were now looking askance upon the Treasury's endeavors, through the removal of the exemption in question, to deprive the wealthy taxpayers of their last remaining means of escape from these rates. But, these pressure groups kept mostly to the background, leaving the field of battle open almost entirely to the organizations of state and local officials which were not as vulnerable to a charge of being motivated in their opposition by selfish reasons.

The opposition succeeded in checking the progress of the Treasury's proposal in 1939. Although the Subcommittee of the Finance Committee, which had been appointed to inquire into the Treasury's proposal, reported by a four-to-two vote in favor of it, neither the Ways and Means Committee nor the Senate Finance Committee took any action in the matter.

The Broader Proposal of 1942

Three years later, following our entrance into the war, the Treasury, with the President's approval, renewed its recommendations for the elimination of the exemption. This time, however, the Treasury broadened its proposal to make it applicable not only to future issues of the bonds in question, but to the now outstanding ones as well. The Treasury had either become convinced, or had become willing to express publicly its previously formed conviction, that the government was neither legally nor morally obligated to continue the exemption theretofore granted under its revenue law, and that any opinion to the contrary was ill-founded. Apparently, too, the

Treasury must have come to the conclusion that the evil of tax exemption was becoming more serious than ever and that it could not be effectively cured by the mere termination of the exemption of future issues. It must also have thought that under the conditions of the war, the national economy would be able to sustain the repercussions that would attend a sudden termination of the exemption much better than it could under conditions of peace. Some of the defenders of the exemption furnished, however, a different explanation for the boldness of the Treasury's proposal. They claimed that the Treasury had probably asked Congress for so much more than it had requested originally in the hope that, as a compromise, it might at least get its original request granted.

The broader suggestion was made originally by the Secretary of the Treasury in a speech delivered in Cleveland on January 26. The suggestion struck the financial market like a thunderbolt, causing the theretofore sharply rising prices of state and municipal securities to drop precipitously. Needless to say, the previous rise was due entirely to the heavy demand for these bonds from taxpayers seeking an escape from the newly enacted or projected high surtaxes. From that time on, investors began to question seriously the possibility of their enjoying indefinitely the advantage of exemption on these bonds and became less willing to pay fancy prices for them.

In recommending the complete and immediate termination of the exemption on all state and municipal issues, the Secretary said that the exemption "gives wealthy taxpayers a possible refuge, not from some income taxes,

but from all income taxes. No matter how much money may be needed for the war, no matter how high the tax rates may be for the others, a taxpayer is not obliged to contribute anything in this hour of his country's peril, if he only can afford to lay his hands upon a sufficient amount of tax-exempt securities.'' In March, 1942, the proposal was submitted by the Treasury to Congress for consideration as a part of its general revenue program.

This new and bolder proposal, however, made only slightly more headway in Congress than did the earlier one. The opposition was just as unyielding as before, and it was unwilling to be moved by considerations of the exigencies of the war. It was led by the so-called ''Conference for State Defense''—an organization comprised mainly of state attorney generals, municipal corporation counsels, and state and municipal fiscal officers. A mountain of legal, economic, and statistical argumentation characterized, unfortunately, by a considerable amount of sophistry and exaggeration, was spread over the records of the Congressional hearings. An impression was conveyed to Congressmen that the proposal would increase the costs of borrowing to the states and municipalities by some 150 to 200 million dollars annually, irreparably injure the credit and finances of these governments, and burden the state and local taxpayers to the exact extent to which it would benefit the federal Treasury. The extent of the tax evasion resulting from the exemption was declared to be insignificant and not worthy of concern. The whole proposal was characterized as a nefarious scheme on the part of the federal bureaucracy to extend its tentacles over the field of state and local government and to choke state and local fiscal autonomy to death.

The Ways and Means Committee rejected the proposal with the result that it never came to a vote before the House. The Senate Finance Committee rejected that part of it which related to existing issues, but approved of the one relating to future issues. The Senate, however, by a vote of 52 to 34 voted the proposal down.

These repeated defeats of the proposal, however, have not settled the issue. The problem will undoubtedly be presented again for Congressional action by the Treasury, if not in the same form, then, after the Supreme Court has acted on it, in another form, until it is finally disposed of in the only way in which it can be disposed of satisfactorily, namely, by the complete or gradual termination of the evil involved.

For tax avoidance emanating from the federal exemption has become a national scandal. The people are not going to tolerate it for any length of time. They will insist on its speedy termination.

With these facts in mind as a background, let us examine in detail the facts involved in the issue, paying particular attention to its fiscal aspects.

Size of Differential in Yields Attributable to Exemption

Unquestionably, the federal exemption makes it possible for states and municipalities to borrow at slightly lower rates of interest than those at which they would be borrowing merely on the basis of the intrinsic qualities of their credit. This reduction in interest rates is obtained by them, however, only on their long-term loans which alone are of interest to the taxpayers seeking exemption. In so far as the federal exemption lowers

the interest costs to states and municipalities, it acts like a federal subsidy. How substantial and essential, however, is this subsidy? This is one of the crucial questions in the present controversy.

The Treasury has estimated the reduction in interest rates now being realized by the states and municipalities on their new borrowings as a result of the exemption at around 0.5 per cent. Professor Harley L. Lutz, the economic expert for the Conference for State Defense, on the other hand, has estimated it at 0.9 per cent.[1] The Treasury's estimate is probably too low, the other one—too high. The latter estimate is based on a spread between the yields of certain high-grade state and municipal securities and certain high-grade corporates. The yields are taken as of a date when the demand for exempt bonds was at its peak. No allowance was made by the estimator for the fact that some of the spread in the yields was due to the higher security of investment afforded by state and municipal bonds than that provided by corporate obligations.[2] Nor was the account taken by him of the fact that the yields of high-grade state and municipals are influenced by the federal exemption to a somewhat greater degree than are the yields of medium-grade state and municipals, which are not in as great a demand from taxpayers seeking exemption.

Institutional investors have recently ceased to buy high-grade state and municipal bonds and have even begun to sell their existing holdings of them, because the pressure of demand for these bonds from taxpayers seek-

[1] U. S. House of Representatives, Committee on Ways and Means, *Hearings on Revenue Revision of 1942*, pp. 1504-7.

[2] This fact was pointed out by Senator Taft in the course of the interrogation of the witness. U. S. Senate, Committee on Finance, *Hearings, 1942*, p. 556.

ing exemption has lowered their yields to a point where they no longer constitute a satisfactory investment for them. But they still continue to buy and hold the medium-grade state and municipal bonds, which comprise the great bulk of all state and municipal issues. Empirical evidence suggests that the differential attributable to exemption in the case of the medium grades is not likely to be in excess of 0.5 per cent. This is the figure quoted by the financial officers of the city of New York and by well informed bond dealers as representing at the utmost the differential in question on New York City bonds, which are being generally classed today as medium-grade bonds. What would probably be the differential in the case of poor-grade state and municipal bonds, it is impossible to say. The differential may be as high as that found to exist in the case of the high grades, or it may even be higher. For bonds of this sort appeal to the speculative investors to whom their high yield and the possibility of their eventual improvement, and hence enhancement in value, may be as important as their exemption privilege. Institutional investors do not generally touch such bonds. The volume of such bonds, however, is considerably smaller than that of either the high- or the medium-grade bonds.

Enough has been said here to indicate that the relatively high differential of 0.9 per cent found to exist in the case of high-grade state and municipal bonds cannot be accepted as being representative of the differentials in question for the entire range of state and municipal offerings. It would seem that a lower differential of, say, 0.7 per cent would be more appropriate for adoption, as an average, for the entire range of such offerings.

This figure lies midway between that offered by Professor Lutz and that supplied by the Treasury.[3]

SAVINGS IN INTEREST COSTS ON PRESENT ISSUES ATTRIBUTABLE TO EXEMPTION

The fact, however, that the states and municipalities may be saving 0.7 per cent of interest on their new issues because of the exemption, does not mean that they are saving it on all their outstanding long-term issues, or might be saving that amount on all their future issues of this sort. So far as the present debt is concerned, it must be observed, first of all, that a portion of it is composed of bonds issued before the enactment of the income tax. The interest cost thereon is obviously not affected by the exemption. Secondly, at least two-thirds of this debt was issued during the period 1920 to 1932 inclusive, when surtaxes were much lower than they are today, being limited first to 50, next to 40, and finally, in 1926, to 20 per cent. The differential in question on this part of the debt on the average could not have been in excess of one-third of one per cent. Thirdly, between one-fifth and one-fourth of this debt must have been issued during the period 1933 to 1940 when the tax rates, though being considerably higher than they were before, were still somewhat lower than they are today, and when

[3] The tendency of estimators generally, heretofore, has been to consider the differential in interest yields attributable to the exemption, as being proportional in each case to the yield of the bond. If the differential is estimated to be 0.5 per cent in the case of a 2 per cent bond, then it is believed to amount to 1.0 per cent in the case of a 4 per cent bond. The first to challenge the correctness of this theory of uniform proportionality of the differential, and to suggest a differentiation in the differentials according to the grades of the securities involved and the sources of demand for them, was John F. Thompson (*see* his article on "The Problem of Tax Exempt Bonds," *Journal of Politics*, IV, August, 1942).

the differential in question, therefore, could scarcely have been greater than 0.5 per cent. Thus, we come to the last portion of the debt, which was issued in 1941 and 1942, under the new tax rates, to which the above quoted differential of 0.7 per cent would apply. But this portion aggregates only some $1,600,000,000 or less than 8 per cent of the entire debt. By and large, therefore, for that entire long-term debt the saving in interest costs as a result of the federal exemption could be fixed, quite generously, at around 0.4 per cent, or at an aggregate sum of $76,000,000 a year. This, then, at the outset, is the extent of the federal subsidy received by the states and municipalities today from the federal exemption.

Needless to say, the savings in interest costs thus received by the states and municipalities on their present debt cannot be taken away from them by the removal of the federal exemption on the present issues. Such a removal can hurt only the holders of these issues who will, as a consequence thereof, suffer a loss in the values of their holdings. The infliction of such a loss may, perhaps, not be altogether fair to some of the holders of these issues. Ways may be found, however, for taking care of all the legitimate equities in the case. This question will be discussed later.

Monetary Value of the Subsidy on Future Issues

Let us now consider how much of a subsidy can the states and municipalities expect to obtain from the exemption of their future issues, and how much of a financial loss they would be likely to sustain, if this exemption were to be withdrawn from them. Manifestly the amount of the subsidy would depend upon the amount

of new debt which the governments involved would be issuing from year to year, and on the size of the differentials in interest rates which exempt bonds would enjoy over the non-exempt ones in the years to come under the tax rates then in effect. It may be safely assumed that very little new debt—not more than $400,000,000 a year—would be issued or reissued by these governments during the period of the war, and that the very substantial differentials in interest rates recently obtained on exempt bonds would, therefore, be of very little value to them during this period. Recent figures show that the aggregate volume of new state and municipal issues during the first nine months of 1942 declined by 40 per cent from the volume of them for the corresponding period of 1941. This decline is likely to become even more accentuated during the succeeding years of the war. On the basis of an aggregate annual volume of $400,000,000 of new issues, including refundings, the subsidy resulting from the exemption during the war period would, for all of our state and local governments taken together, amount to but a few million dollars a year.

It seems reasonable to assume that during the postwar period when the states and municipalities will resume borrowing on a large scale, the tax rates in effect would be much lower than they are today. Under these conditions the differentials in interest rates enjoyed by exempt bonds would likewise be lower than they are now. They would probably also be lower because of the vast increase in the supply of state and municipal bonds which would be taking place at that time. If we assume that the differential in question would drop during the postwar period to 0.5 per cent and that the states and municipalities would have at the end of the war a new debt of one

and a half billion dollars, five years later one of ten billion dollars, and in *x* year one of nineteen billions which, as stated, is the amount of the present long-term debt—then they would be realizing under the federal exemption on their new debt a total saving in interest costs on the dates mentioned, of ten, fifty, and ninety-five million dollars respectively. These, then would be the amounts of the annual federal subsidy which the states and municipalities would be deriving successively in the postwar period from the exemption on their future issues. These sums also measure the financial losses which they would be sustaining at the times mentioned in the future, if this subsidy were to be denied to them from now on. It is seen that the subsidy involved is small.

Professor Lutz in his report for the Conference for State Defense computed the monetary value of the exemption to the states and municipalities, on their future issues, however, in quite a different fashion.[4] He took for the amount of these issues the now outstanding debt of $19,000,000,000, without indicating that it would take some years for these issues to aggregate any such sum. Next, he applied thereto the differential of 0.9 per cent found by him to obtain in the case of recent issues, as if such a differential, even if it were correctly computed for the conditions of the wartime tax rates, could be expected to obtain under conditions of peacetime tax rates.

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[4] U. S. House of Representatives, Committee on Ways and Means, *Hearings on Revenue Revision of 1942*, pp. 1507-8; *see also* Prof. Lutz's testimony before the U. S. Senate Special Committee on Taxation of Governmental Securities and Salaries, 1939, pp. 93-202; and the author's testimony before the same Special Committee, pp. 546-57.

By adopting this method of computation, the economist for the Conference arrived at a figure of $175,000,000 as representing the annual money value of the exemption to the states and municipalities on their future issues, in the years to come. This, he claimed, represented the extent of the additional burdens which state and local taxpayers would have to shoulder annually in the future, if the exemption on their future bonds were to be removed at this time. In none of his calculations did the expert for the Conference indicate that the date when the subsidy on the new issues may reach this sum is somewhat removed in the future, and that in the meanwhile the subsidy in question, and, hence, also the prospective financial losses to the states and municipalities from its abolition, would be relatively slight.

Calculations of this sort have tended to create in the minds of Congressmen, and the people generally, totally erroneous impressions as to the real size of the subsidy in question, and also as to the real extent of the financial loss which would be involved for the governments concerned in the event of its withdrawal.

Lack of Real Need for the Subsidy

Besides being relatively unimportant, the subsidy in question is unnecessary. For a hundred or more years before the establishment of the exemption, states and municipalities were borrowing on their credit without difficulty, and they will continue to do so with the same ease if the exemption is withdrawn. The credit of the states and municipalities rests on their taxing powers, the soundness of their finances, the wealth and industry of their populations, and the competence and integrity

of their representative assemblies and administrations. It would be a sorry day for the governments concerned if their credit rested to any large degree on anything else. The state and municipal officials who claim that their governments would be unable to borrow if the artificial prop of the exemption in question were to be withdrawn from them are, unwittingly, maligning the credit of their own governments.

It is claimed by some of the defenders of the exemption that the removal of the exemptions would prevent municipalities, which have to pay 5½ or 5¾ per cent interest on their loans, from borrowing altogether, inasmuch as the interest rates on their loans would in that case rise above the legal limit of 6 per cent. This indeed is an extraordinary claim. If some of the municipalities cannot borrow normally on the basis of the intrinsic quality of their credit at less than 6 per cent, then, perhaps, they should be prevented from borrowing, for there must be something wrong in that instance either with their finances or with their methods of borrowing. If, on the other hand, reference is had to some future period of a great financial stringency when high interest rates generally would prevail, then, obviously the subsidy in question is too unimportant as a remedy to be even worthy of discussion.

Accidental Origin of the Subsidy

The subsidy involved in the exemption is totally accidental in its origin. As shown by historical inquiries, the exemption was incorporated in the original income tax law of 1913 by its authors in order to avoid raising a constitutional issue at the time, and not for any other

reason. The amount of revenue which could be obtained from the inclusion of the income from state and municipal bonds in the base of the tax, under the then contemplated rates of 1 to 6 per cent, was bound to be very small. Hence, it did not seem wise to the authors of the measure on account of so small an amount of revenue to risk imperilling the passage of the bill. Yet, had the item in question been included in the tax base and the bill passed just the same, the acrid controversy, which had developed later with respect to the right of Congress to levy the income tax on the income from the source involved, would probably have been very largely spared. For we would have had then shortly thereafter an interpretation by the court on the scope of that right under the new constitutional amendment. A few years later, when the surtaxes of the income tax were increased to more than 70 per cent and when the government began to lose substantial revenue as a result of the exclusion of this item, the mistake made in 1913 was realized by the Treasury. But its correction had then become extremely difficult. For the state and municipal officials, realizing the advantage which the exemption of their securities from federal taxation was giving them in the market, offered strong objections to the termination of the exemption. Taxpayers who invested in state and municipal bonds in order to escape the taxes, also raised a cry that they had a vested right in the continuance of the exemption. These objections have persisted ever since.

Vicious Character of the Subsidy

Even though the subsidy in question is quite unimportant and unnecessary, it might have been tolerated were

it not for the fact that it is associated with the avoidance by the federal taxpayers of their due obligations to the government, and to that extent is vicious. We have seen that the Treasury has estimated the loss of revenue sustained by it from the exemption, at $185,000,000 under the 1940-41 tax rates and at $275,000,000 under the 1942 tax rates; and, on the other hand, that the states and municipalities are deriving a reduction in interest rates because of the exemption of only $76,000,000 a year at the utmost. Of this sum of $76,000,000 saved by the states and municipalities, not more than one-half, or $38,000,000, could possibly have come out of the pockets of the bondholders to whom the exemption feature of the bonds is of value. For the holdings of this group, according to recent estimates of the Treasury, are only slightly in excess of one-third of the total volume of the outstanding state and municipal bonds. The other $38,000,000 saved to the states and municipalities must have come out of the pockets of the institutional investors.

This means that the net gain realized by the taxpayers in question from the exemption must have amounted in 1940 and 1941 to some $147,000,000 a year, or 80 per cent of the amount of revenue lost to the Treasury, and may be expected in 1943 to amount to some $237,000,000, or 86 per cent of the Treasury's revenue loss. The wealthy taxpayers buying state and municipal bonds are, therefore, the prime beneficiaries of the exemption. The state and local governments are only secondary beneficiaries. The subsidy received by them functions, therefore, very largely like a screen behind which wealthy taxpayers may, with impunity, escape federal taxation.

Why Wealthy Taxpayers Are Chief Beneficiaries

Two facts working in conjunction with each other afford an ample explanation of why taxpayers investing in state and municipal securities are not compelled to pass to the states and municipalities, in the form of a lower yield, the full benefit of the exemption received by them. The first fact is that the bulk of the bonds is ordinarily taken up by banks, insurance companies, educational foundations, pension funds, and other institutions, and funds which are either already exempt from all income taxes or else are ordinarily subject to only very moderate income taxes. These institutions and funds ordinarily are not concerned with the exemption, and demand an interest rate adequate enough, in the light of the prevailing money rates generally and of the quality of the bonds in question, to provide them with an appropriate return.

Hence, although the taxpayers buying the tax-exempt bonds, taken as a group, might be willing to accept a much lower yield on the bonds than that demanded by the institutions and funds in question, they do not need to do so. They can enjoy the higher yields demanded by the latter, which the states and municipalities must pay in order to place all their bonds.

The second reason why the taxpayers investing in state and municipal bonds do not sustain a reduction in the yield on their bonds corresponding to the gains obtained by them from these bonds in saved taxes, is that these taxpayers belong to various income groups and are subject to different tax rates and, therefore, are not in equal competitive positions as buyers of these bonds. To a taxpayer subject to a 90 per cent tax rate

on a portion of his income, the state or municipal bond, so far as this portion is concerned, has a tremendous value. It is worth to him almost ten times as much as a comparable taxable bond furnishing the same amount of yield. As compared with the 4 per cent taxable security on which the government would take 3.6 per cent in taxes leaving to the taxpayer for his own uses only a return of 0.4 per cent, even a state or municipal bond yielding only 0.5 per cent is profitable. He could well afford, so far as the investment of this portion of his income is concerned, to sustain a reduction of 3.5 per cent interest on the exempt bond. On the other portions of his income to which lower tax rates apply, he could not afford to accept on exempt bonds yield reductions of this size. On some portions of his income, on which the surtaxes are low, he could accept only very slight reductions. Less wealthy taxpayers could accept only smaller reductions in the yields. The actual reduction for all investors would be fixed by the situation of the marginal investor interested in tax exemption in whose case the acceptable reduction would about equal the saving available to him in taxes applicable to his income. This actual reduction in the yield would allow all taxpayers with larger incomes than that possessed by the marginal investor, large net profits from the investment in the tax-exempts. Thus, even if the supply of state and municipal bonds were large enough merely to meet the demand for them from taxpayers subject to surtaxes, and none of these bonds had to be placed with financial institutions, the wealthier taxpayers would still be getting savings in taxes from investments in state and municipals, far in excess of reductions in the yield

which they would be compelled to accept thereon on account of the exempt feature of these bonds.

It is clear, therefore, that the benefit which the state and local governments receive from the exemption of interest on their bonds from federal taxation are but mere crumbs from the table of the tax evaders who are the principal feasters in the case, and that the position in which the states and municipalities have been placed, as a result of these exemptions, is, to say the least, undignified. Rather than resisting the termination of the exemption, the state and local officials should be among the foremost proponents of such action. They should be pleading now with Congress to eliminate the exemption so as to put a stop to the conversion of their obligations by the market into something that could be called more appropriately, as one financial writer put it, "Certificates of Tax Evasion." They should be pleading for such action on the score that they do not wish their governments unwittingly to participate in a situation which is not in keeping with their honorable traditions and objectives.

A Flimsy Defense

Various attempts have been made by the defenders of the exemption to cover up the somewhat embarrassing connection which has developed between the present boom in the market for state and municipal securities and the efforts of wealthy taxpayers to evade the highly progressive federal surtaxes. It has been asserted that the taxpayers who seek exemption in purchasing the bonds do not really evade the taxes; that they are compelled by market forces to surrender to state and local govern-

ments, in lower yields, practically every dollar of federal taxes saved by them under the exemption. An impression has been conveyed that these taxpayers are thus mere transfer agents relieving state and local taxpayers of certain burdens of support of state and local bond interest and passing these burdens on to the shoulders of federal taxpayers, generally, who are better able to bear them. This theory has been presented by economists of standing, although it flies in the face of simple economic facts, and is contrary to common sense.[5]

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[5] Thus, testifying before Congress for the Conference on State Defense, Professor Fred R. Fairchild offered the following pseudo-scientific argument: "The investors in future issues of State and municipal bonds will enjoy no privilege on account of exemption from Federal income tax. How could they have a privilege when the bonds are sold in a free market and anyone is free to subscribe for or purchase them if he cares to pay the market price? Exemption from Federal income tax will be offset by low yield, on a basis of equality with the next yield of other investments. In other words, the investor pays for his tax exemption by taking a low rate of interest. Where is the privilege?

"Nor does the Government have the power, by making the interest on these future bond issues taxable, to impose a special burden on the investor. He would in consequence, merely receive a higher rate of interest or buy the bonds at a lower price, so that equality of net yield between this and other investments of similar quality would be preserved." (U. S. Senate, Finance Committee, *Hearings, 1942*, p. 633.)

The witness completely ignored the fact indicated above that (a) some investors buy the bonds in question for other reasons than their exemption privilege; and that (b) those interested in the exemption are subject to different surtaxes and, hence, derive different degrees of advantage therefrom.

When Congressman Robertson of the Ways and Means Committee asked him whether he, the Professor, in the light of his fuller knowledge, could assure him, the Congressman, that if he voted against taxing the income from future issues, he "will not be guilty of giving favored treatment to a relatively small group that can escape a tax burden in that manner," Professor Fairchild responded, "I think I can honestly give you that assurance, sir." To which the Congressman replied with a "Thank you." (U. S. House of Representatives, Committee on Ways and Means, *Hearings, 1942*, p. 1524.)

Professor Lutz in his testimony similarly contended that the purchasers of exempt bonds, by and large, pay for the privilege of exemption in lower bond yields (*Ibid.*, p. 1591); that "the figures do not bear out . . . the point that is so often made . . . that rich people invest large amounts of their assets in State and municipal bonds for the purpose of securing exemption from income tax." (U. S. Senate, Finance Committee, *Hearings, 1942*,

Every dealer in state and municipal bonds knows that the individuals who eagerly buy these bonds, do so because of the great advantage which they derive from their tax-exempt privilege. With the aid of such tables as the one entitled "Tax-Free vs. Taxable Bonds," which is in part reproduced here, any bond dealer can demonstrate to a large taxpayer that he can derive a very substantial saving in taxes by investing some of his funds in such bonds, and any such taxpayer can readily convince himself of that fact. The bond dealers would be amused by the fancy arguments of the economists just cited to the effect that little or no advantage can be obtained by large taxpayers from investing some of their assets in tax-exempt bonds.

One of the most eloquent answers to these devious theories is furnished by the actual records of the sources of income and amounts of tax payments made by large taxpayers. Such records have been supplied recently by the Treasury to Congress for twenty-five selected individuals whose income ranged between $340,000 and $5,-400,000. The data presented are summarized in the accompanying table. It will be noticed in this table that

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p. 554.) He said that he is forced himself "to the view that the range of persons or investors for whom the immunity would acquire greatly increased value is rather small, both as to the number of such persons and as to the proportion of the total debt that would be affected thereby." (*Ibid.*, p. 555.)

The witness took the position that taxation of state and municipal bonds "will increase local taxation by about as much as it increases the Federal revenue" and will "in an effort to apply progressive taxation to a minor fraction of the interest paid on State and local bonds . . . really result in a greater regressiveness in the local taxes, and particularly the property tax." (U. S. House of Representatives, Committee on Ways and Means, *Hearings, 1942*, p. 1509.) He maintained that the proposal is merely "a process of robbing Peter to pay Paul," Peter in the case being "the citizen who must pay the heavier local taxes in order to provide the increased debt service on taxable bonds" and Paul, presumably being the United States Treasury. (U. S. Senate, Finance Committee, *Hearings, 1942*, p. 549.)

The statistical reasoning presented by the witness in support of this conclusion was exceedingly obscure.

Tax-Free vs. Taxable Bonds
(*1942 Revenue Act Edition*)

Income from certain federal, state, and municipal bonds is exempt from federal income tax, rate of which ranges from 6% to 93%, ding to amount of income. This table, prepared by *The Bond Buyer*, indicates the approximate yield which taxable bonds must return ual the return from tax-free bonds yielding 1% to 4½%, when held by investors enjoying surtax net incomes of $2,000 or more, and rations subject to the top bracket corporate surtax.

	Surtax Brackets—Thousands of Dollars													
ax ee er- t es	Not Over $2 (24%)	$10 to $12 (43%)	$20 to $22 (60%)	$32 to $38 (69%)	$44 to $50 (74%)	$50 to $60 (77%)	$60 to $70 (80%)	$70 to $80 (83%)	$80 to $90 (86%)	$90 to $100 (88%)	$100 to $150 (90%)	$150 to $200 (92%)	Over $200 (93%)	Corp. Tax Equiv. (40%)
00	1.32	1.75	2.50	3.23	3.85	4.35	5.00	5.88	7.14	8.33	10.00	12.50	14.29	1.67
25	1.64	2.19	3.12	4.03	4.81	5.43	6.25	7.35	8.93	10.42	12.50	15.62	17.86	2.08
50	1.97	2.63	3.75	4.84	5.77	6.52	7.50	8.82	10.71	12.50	15.00	18.75	21.43	2.50
75	2.30	3.07	4.37	5.65	6.73	7.61	8.75	10.29	12.50	14.58	17.50	21.87	25.00	2.92
00	2.63	3.51	5.00	6.45	7.69	8.70	10.00	11.76	14.29	16.67	20.00	25.00	28.57	3.33
25	2.96	3.95	5.62	7.26	8.65	9.78	11.25	13.24	16.07	18.75	22.50	28.12	32.14	3.75
50	3.29	4.39	6.25	8.06	9.62	10.87	12.50	14.71	17.86	20.83	25.00	31.25	35.71	4.17
75	3.62	4.82	6.87	8.87	10.58	11.96	13.75	16.18	19.64	22.92	27.50	34.37	39.29	4.58
00	3.95	5.26	7.50	9.68	11.54	13.04	15.00	17.65	21.43	25.00	30.00	37.50	42.86	5.00
25	4.28	5.70	8.12	10.48	12.50	14.13	16.25	19.12	23.21	27.08	32.50	40.62	46.43	5.42
0	4.61	6.14	8.75	11.29	13.46	15.22	17.50	20.59	25.00	29.17	35.00	43.75	50.00	5.83
5	4.93	6.58	9.37	12.10	14.42	16.30	18.75	22.06	26.79	31.25	37.50	46.87	53.57	6.25
0	5.26	7.02	10.00	12.90	15.38	17.39	20.00	23.53	28.57	33.33	40.00	50.00	57.14	6.67
5	5.59	7.46	10.62	13.71	16.35	18.48	21.25	25.00	30.36	35.42	42.50	53.12	60.71	7.08
0	5.92	7.89	11.25	14.52	17.31	19.57	22.50	26.47	32.14	37.50	45.00	56.25	64.29	7.50

these individuals derived anywhere from 15 to 74 per cent of their income from state and municipal bonds; and that, consequently, instead of having to pay taxes of 66 to 79 per cent, they paid, in all but six cases, taxes of only 15 to 38 per cent. Instead of collecting from these twenty-five individuals a revenue of $17,900,000, the Treasury collected one of only $10,900,000. Had these taxpayers invested all of their funds in taxable securities, their gross income would have been larger on account of the higher yields of such securities, but their net income, after payment of taxes, would have been considerably smaller than it was. While we cannot know how typical these data are, the Treasury asserts that records of this sort could be multiplied from the existing income tax returns. These records controvert the fine spun theories of the apologists of the tax exemption beyond any peradventure.

The evidence clearly shows that ever since the rates of income taxes have been materially increased, tax evasion under the exemption privilege has become fairly widespread, and is today seriously undermining the integrity of our entire system of progressive taxation.

Need for Speedy Termination of Exemption on both Future and Present Issues

Public interest requires the termination of the exemption privilege at the earliest possible time. It will not suffice to terminate it merely with reference to the future issues, for the existing supply of state and municipal bonds in the hands of financial institutions is sufficient to take care of the demand from taxpayers seeking exemption for federal taxation for many years to come. Huge transfers of state and municipal holdings from such insti-

AXES SAVED BY 25 SELECTED TAXPAYERS IN 1941 THROUGH THEIR INVESTMENTS IN STATE AND MUNICIPAL BONDS [a]

Income Received by Taxpayer (In thousands)				Taxes (In thousands)			Ratio of Taxes to Income		
From exempt bonds	From other sources	Total	Ratio of Exempt to Total Income	Actually Paid in 1941	Which would have been paid had all income been taxable	Loss to treasury resulting from exemption	Taxes actually paid in 1941	Taxes which would have been paid if all income were taxable	Taxes saved because of exemptions
$221.9	$601.9	$823.8	26.9%	$424.2	$595.7	$171.5	51.4%	72.3%	20.9%
236.2	207.9	444.1	53.2	126.4	301.2	174.8	28.5	67.8	39.3
260.4	148.9	409.3	63.6	87.0	276.8	189.8	21.3	67.6	46.3
230.9	1,337.5	1,568.4	14.7	999.2	1,181.6	182.4	63.7	75.3	11.6
226.9	1,081.0	1,307.9	17.3	796.6	975.8	179.2	60.9	74.6	13.7
215.0	147.8	362.8	59.3	83.8	241.8	158.0	22.9	66.6	43.7
349.5	144.2	493.7	70.8	82.6	339.6	257.0	16.7	68.8	52.1
820.7	835.6	1,656.3	49.6	605.0	1,251.6	646.6	36.5	75.6	39.1
162.7	249.8	412.5	39.4	158.1	279.2	121.1	38.3	67.7	29.4
351.7	275.1	626.8	56.1	175.9	442.7	266.8	28.1	70.6	42.5
330.7	373.6	704.3	47.0	249.9	503.0	253.1	35.5	71.4	35.9
773.0	765.1	1,538.1	50.3	549.4	1,157.7	608.3	35.7	75.3	39.6
668.7	305.9	974.6	68.6	198.6	712.8	514.2	20.4	73.2	52.8
817.4	288.9	1,106.3	73.9	186.6	817.2	630.6	16.9	73.9	57.0
394.6	376.6	771.2	51.2	250.7	553.2	302.5	32.5	71.7	39.2
296.5	603.0	899.5	33.0	423.2	653.0	229.8	47.0	72.6	25.6
404.3	160.1	564.4	71.6	94.8	395.3	300.5	16.8	70.0	53.2
316.3	915.1	1,231.4	25.7	666.8	915.8	249.0	54.1	74.4	20.3
313.4	278.7	592.1	52.9	179.2	416.6	237.4	30.3	70.4	40.1
356.5	135.4	491.9	72.5	75.1	336.9	261.8	15.3	68.5	53.2
1,083.7	4,321.4	5,405.1	20.0	3,380.3	4,251.3	871.0	62.5	78.7	16.2
172.6	170.7	343.3	50.3	102.2	227.2	125.0	29.8	66.2	36.4
226.2	166.9	393.1	57.5	99.5	264.5	165.0	25.3	67.3	42.0
314.8	331.7	646.5	48.7	217.5	457.3	239.8	33.6	70.7	37.1
424.8	218.9	643.7	66.0	136.2	366.3	230.1	21.2	56.9	35.7
$9,969.4	$14,441.7	$24,411.1	40.8%	$10,348.8	$17,914.1	$7,565.3	42.4%	73.4%	31.0%

ıpted from Table 7, accompanying testimony by Mr. Randolph Paul, Special Counsel to the Treasury Department. U. S. House of atives, Committee on Ways and Means, *Hearings, 1942*, p. 3090.

tutions, to which tax exemption is of no importance, to taxpayers to whom it is, have been going on already for the past few years and are likely to continue. It is of advantage to the institutions to dispose of their holdings of the tax-exempt bonds while large premiums thereon can be realized. The reports of the New York State Banking Department show that the Mutual Savings Banks of that state have reduced their holdings of state and municipal bonds from $560,000,000 in 1933 to $223,000,000 by the end of 1941. In the course of a few months in 1942 several insurance companies sold some hundred or more million dollars of their holdings of such bonds at premiums of 25 points and more, replacing them with federal and other non-exempt obligations. Commercial banks and other corporations which heretofore have been little interested in tax-exempt securities are becoming interested in them now, in view of the fact that they have been subjected under the new law to income taxes of 40 per cent. Thus the Treasury is being faced with the prospect of considerable tax evasions under the exemption from an altogether new source.

The only effective way, therefore, to plug the loop-hole of the tax exemption is to terminate the latter also in application to the present issues, if not *in toto*, at least in large part.

Possibilities of a Compromise Arrangement

The federal government is not legally obligated to continue the exemption on the existing state and municipal issues. It may be morally obligated, however, to do so in so far as the rates of the income tax which were in vogue prior to 1932, and possibly even prior to 1940, are con-

cerned. For when these earlier rates were in effect a notion was prevalent among the public that the state and municipal bonds were constitutionally immune from federal income taxation. The rates in question were moderate and no great agitation to abolish the exemption of the bonds from these rates was carried on at that time. The purchasers of the bonds can, therefore, rightfully claim that they had reason to believe, at the time, that the bonds in question would be permanently exempt from the existing tax rates. It may be wise for the government under these circumstances to recognize the equities of these bond holders in the exemption of their bonds from these earlier rates.

A very different situation, however, developed after the enactment of the aforementioned increases in the rates. Serious doubt began to be cast soon after the introduction of the first of these increases, in 1932, on the validity of the theory of the constitutional immunity of the state and municipal bonds from federal taxation. An insistent demand developed for the abolition of the exemption privilege in question. Even though the proposals made to abolish the exemption related at first only to future issues, there could be no assurance that they would not be extended in time also to apply to the existing ones. The purchasers of the bonds during this period could scarcely claim that they were unaware of the existence of this agitation, the formulation of new constitutional theories on the subject of the tax exemption privilege, and the development of a new temper on the constitutional questions generally on the part of the Supreme Court. When they purchased the bonds, they took a chance that the exemption might be revoked sometime. They should have especially foreseen the possi-

bility of the revocation of the exemption with respect t the high rates of taxation of wartime. On the other hanc the investors who had purchased the bonds during th years when lower rates prevailed, can scarcely claim moral right to the enjoyment of the exemption from th higher tax rates enacted during later times. Under th circumstances, the existence of any moral obligation o the part of the federal government to maintain the ex emption on the existing issues in relation to the highe tax rates in vogue since 1932, and especially 1940, appear to be extremely questionable.

A recent writer on the subject has proposed that th exemption be retained on the existing issues in relatio to the tax rates in effect before 1941, but be abolished wit respect to higher rates.[6] This would be a very generous concession to the holders of the existing issues. A somewhat less generous concession would be one limiting the exemption on existing issues to the tax rates in effect before 1932. It is not necessary here to discuss in detail the merits of these two proposals. It is important merely to note that some reasonable compromise between the proposal to terminate the exemption privilege on the existing issues in full immediately and the proposal to retain it for the rest of the life of these issues may be worked out.

Summary

To summarize this discussion, the exemption of state and municipal bonds from federal income taxation has produced only a slight reduction in the interest rates on these bonds. The subsidy thus obtained by the states and municipalities on their borrowings has been quite un-

[6] Thompson, *op. cit.*

necessary, for these governments ordinarily experience no difficulty in obtaining loans at reasonable costs if their finances are in order.

The exemption makes possible the evasion by large taxpayers of the high surtaxes of the income tax, through the simple expedient of their investing some of their assets in tax-exempt bonds, and is to this extent reprehensible. The consequent losses of revenue to the federal Treasury and the savings in taxes obtained by large taxpayers ordinarily exceed by far the savings in interest costs realized by the state and local governments under the exemption. The prime beneficiaries of the exemption privilege in question are thus not the states and the localities, but the tax evaders. In addition to depriving the federal government of a substantial amount of revenue, the exemption works to undermine the integrity of its income tax and tax system generally.

It is exceedingly important, therefore, that the tax exemption privilege be terminated at the earliest possible time. The accomplishment of this result would be relatively easy so far as future issues of the bonds are concerned. In the case of the present issues, however, the immediate and complete termination of the exemption would be somewhat difficult, for it would involve the impairment of the equities of some innocent investors who could rightfully claim that they had no proper warning that the tax exemption privilege might be terminated some day. It should be possible, however, to develop some reasonable plan of a partial termination of the exemption on the existing issues which would give due recognition to all legitimate property rights. The present period is most propitious for the effectuation of this important change.

CHAPTER IX

SCOPE AND POSSIBILITIES OF SERVICE PAYMENTS IN LIEU OF PROPERTY TAXES

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THE WAR has made it necessary for the federal government to acquire more and more real estate to house the personnel and activities of the Army and Navy and to house or furnish space for federal departments and agencies engaged in war work of various kinds. On November 18, 1942, the Office of War Information reported that since Pearl Harbor the Army and Navy have bought, or are in the process of buying, private property equal to the combined areas of Massachusetts, Connecticut, Rhode Island, Delaware, the District of Columbia, and four-fifths of New Jersey. Before the war is over, about 30,000,000 acres, equal to the entire area of all New England, will be taken over by the government, according to OWI.[1] This land will be used for army camps, naval bases, air fields, houses, bombing ranges, artillery fields, shipyards, dry docks, and a thousand and one other uses. In Atlantic City 47 hotels containing 11,000 rooms

[1] A federal study released in 1937 estimated that on June 30, 1937, one-fifth of all the real estate in the United States was owned by the federal government. *See* House Document 111, 76th Congress, 1st Session, *Federal Ownership of Real Estate and Its Bearing on State and Local Taxation.* Most of this real estate is located in western states and has never been privately owned. Since 1937 no figures were available until the OWI report and that report does not include real estate acquired between June 30, 1937, and December 7, 1942, when Pearl Harbor was bombed.

were taken over by the Lands Division of the Department of Justice 48 hours after the War Department requested such action. The world's largest hotel, the Stevens in Chicago, was commandeered in one day.

The War and Navy Departments have taken over some industrial plants for the manufacture of various implements of war. In many cases these industrial plants are not operated directly by Army or Navy personnel, but by regular industrial companies hired to take over the manufacturing operations because of the peculiar industrial experience of such companies. These Army and Navy plants really operate just like private industries except that they pay no local or state taxes on the real estate they occupy.

All of this federal acquisition of real estate means immediate removal of such real estate from state and city tax rolls. The loss in state and municipal revenues from this source will, therefore, mount steadily at a time when municipal costs are naturally rising because of the war emergency. The question arises as to just what can be done to take care of this loss in local and state tax revenues. Should the federal government make payments in lieu of the tax revenues lost through federal realty acquisitions? It is submitted that the government should, and this discussion will be devoted to a consideration of the present status of payments in lieu of taxes on federally owned real estate or public projects. Also, because there has been real progress in connection with the same problem with respect to local public housing projects which are given federal financial assistance, this discussion will summarize developments with respect to such projects even though they, as local projects, belong to a different category altogether than do federal projects.

The Case for Payments in Lieu of Taxes

It is, of course, readily apparent to all that if the federal government moves into one of our large cities, like Detroit for example, and takes over a substantial percentage of the taxable real estate, this will mean that the city of Detroit must raise its tax rate to other real estate owners to compensate for the loss in revenues due to this federal ownership, or the city must tap a new source of revenue to take care of such loss. It seems unfair that Detroit, just because certain real estate located therein is best adapted to federal purposes, should incur a large loss in revenue while other cities, less desirably located from the federal viewpoint, do not lose any revenue as the federal government fails to take any land located in those cities. The war is a national effort and the cost of the war should be borne by the entire nation. It is eminently unfair to require Detroit or any other city to bear a disproportionate share of the cost of the war. The fair solution seems to be payments in lieu of taxes to the localities suffering a loss in local tax revenue because of the taking of land by the federal government. In order that the entire cost of the entire war may be spread over the entire nation, these payments in lieu of taxes should come out of the federal treasury to which all residents of the United States now contribute through the various forms of federal taxation. The same principle of spreading the cost over the entire nation can also be applied to nonwar federal projects which are for the benefit of the entire nation. Where particular federal projects, the Tennessee Valley Authority for example, are income-producing and benefit particular communities, the payments in lieu of taxes should be, and usually are, made out of the earnings of such projects.

In other words, consideration should be given to such relevant factors as the burdens placed upon the local community to service the federal property involved; the benefits—economic or social—derived by the community; the extent to which the property is revenue-producing; the extent to which the property is intended for local or federal advantage; and the extent to which the property may involve a federal subsidy or grant to the local community. The basing of payments in lieu of taxes upon such considerations would make for a much more real uniformity than a policy providing for the same tax payments for all federally owned or federally assisted projects regardless, for example, of the burdens or benefits involved to the local community.

Legal Problems

Under decisions of the Supreme Court of the United States the theory that federal property is immune from state and local taxation still prevails.[2] The Supreme Court has held that the federal government may waive this immunity[3] and Congress has done so in connection with real estate owned by the Reconstruction Finance Corporation and other federal agencies and departments.[4] Some states have adopted statutes exempting all federally owned real estate from state and city taxation.

[2] See *McCulloch* v. *Maryland*, 4 Wheaton 316 (1819); *Jaybird Mining Company* v. *Weir*, 271 U. S. 609 (1926); *Domenech* v. *National Bank of New York*, 294 U. S. 199 (1935). On March 13, 1939, the United States Supreme Court refused to grant a Writ of Certiorari, thereby leaving in effect the decision of the Circuit Court of Appeals that real estate purchased by the United States for a post office site but used as a privately operated bus terminal was not taxable by the city of Springfield, Massachusetts. *City of Springfield* v. *United States*, 99 Fed. (2d) 860.

[3] *Van Allen* v. *Assessors*, 3 Wall. 573 (1866).

[4] Mr. Edward H. Foley, Jr., then General Counsel of the Treasury Department of the United States, in his address "Tax-Exempt Securities and National Defense," in *Municipalities and the Law in Action* (1940), p. 166

The present legal status of payments in lieu of taxes is that in the absence of specific federal legislation such payments may not be made on federally owned property.

DEVELOPMENT OF CONCEPT OF PAYMENTS IN LIEU OF TAXES

The idea of payments in lieu of taxes has developed within the last ten years as the federal government and its agencies have entered the public utility, public housing, and money lending fields heretofore occupied chiefly by private enterprise. The Public Works Administration, Resettlement Administration, Farm Security Administration, United States Housing Authority, Tennessee Valley Authority, Reconstruction Finance Corporation, Home Owners' Loan Corporation, and other federal agencies, by their gradually expanding activities, have focused attention on this subject of payments in lieu of taxes on federally owned or federally aided projects.

All parties concerned—the Congress, the President, the federal departments and agencies, and state and local governments and their taxpayers—seem to agree that payments to compensate states and cities for loss of tax revenues due to federal ownership of real estate should

states: "A striking development is that Congress has, in many instances consented to the states exercising the power of taxation over government property which would otherwise be exempt. . . . See, for examples of statutes which specifically authorize the levy of taxes by states: the Act of January 26, 1847, 9 Stat. 118; Act of July 10, 1886, 24 Stat. 143 (U. S. C., title 43, sec. 882); Act of August 13, 1894, 28 Stat. 278 (U. S. C., title 31, sec. 425); Act of March 3, 1901, 31 Stat. 1083 (U. S. C., title 25, sec. 319); Act of May 27, 1902, 32 Stat. 275 (U. S. C., title 25, sec. 379); Act of March 11, 1904, 33 Stat. 65 (U. S. C., title 25, sec. 321); Act of May 8, 1906, 34 Stat. 183 (U. S. C., title 25, sec. 349); Act of June 14, 1906, 34 Stat. 263; Act of March 1, 1907, 34 Stat. 1016 (U. S. C., title 25, sec. 412); Act of August, 19, 1937, 50 Stat. 700 (U. S. C., Sup. IV, title 16, sec. 403c-1); Act of August 25, 1937, 50 Stat. 806 (U. S. C., Sup. IV, title 25, sec. 510); and, Act of December 6, 1937, 51 Stat. 4 (U. S. C., Sup. IV, title 12, sec. 1768); National Housing Act Amendments of 1938, 52 Stat. 22 (U. S. C., Sup. V, title 12, sec. 1714); Act of March 8, 1938, 52 Stat. 108 (U. S. C., Sup. V, title 15, sec. 713a-5)."

be made. The difficulty is in arriving at a formula to determine the amount of such payments that should be made in each case. As already indicated, the problem is complicated by the fact that a "uniform" formula in the sense of an arbitrary application of an identical formula to all types of federally owned or federally assisted projects, regardless of either the burdens placed upon, or benefits to, the community as a result of such projects, would appear inappropriate.

The war created the occasion for the great increase in federal ownership of real estate which is indicated by the OWI report cited in the opening paragraphs of this paper. The war also came at a time when no basic formula or principle for payments in lieu of taxes had yet been arrived at, so the problem is now a greater one in every respect. As will be indicated hereinafter, various formulas for payments in lieu of taxes are applied in legislation relating to various federal departments and agencies. The formulation of a basic federal policy is still delayed until the Federal Real Estate Board files its report sometime in 1943.[5]

The most progress toward uniformity in federal policy on payments in lieu of taxes has been made in the field of federally owned or assisted war and public housing. The experience in the public housing field is therefore given major consideration in this study.

The Congress has already authorized funds in excess of $2,000,000,000 for war housing projects ranging from family dwelling units to dormitory apartments, trailers, portable houses, and dormitories for single persons. As of September, 1942, more than 1300 separate housing

[5] *Infra*, p. 149.

projects had been planned. Removal of the land occupied by these projects from local tax rolls means a real revenue loss to the localities in which the projects are located. The Congress and the Federal Public Housing Authority realized this and the sweeping new, liberalized, and uniform policy for the making of payments in lieu of taxes on such projects has been authorized by the Congress and carried out by the FPHA.

The new policy was announced by FPHA on September 29, 1942, and it is expected to improve the tax relations between public housing projects and local governments by (1) giving greater certainty to contributions which may be expected in municipal budgets; (2) equalizing treatment among municipalities and on public housing built under various acts; (3) increasing contributions to the increased costs of municipal services such as schools, health, police, fire, etc., occasioned by the inmigration of war workers to new housing developments. A review of the new regulations on these payments in lieu of taxes, together with a summary of the applicable legislation reveals the far-reaching character of this change in basic federal policy.

Lanham Act War Housing Projects

The basic statute with respect to war housing projects is the so-called "Lanham Act," Public Law 849, 76th Congress, 54 Stat. 1125 (as amended by Public Laws Nos. 42, 137, 409, 522, and 723, 77th Congress). Prior to January 21, 1942, Section 9 of the Act provided that the Federal Works Administrator may enter into agreements to pay annual sums in lieu of taxes to local political sub-

divisions. Public Law 409, approved January 21, 1942, amended this provision to read:

> The Administrator shall pay from rentals annual sums in lieu of taxes to any State and/or political subdivision thereof, with respect to any real property acquired and held by him under this Act, including improvements thereon. The amount so paid for any year upon such property shall approximate the taxes which would be paid to the State and/or subdivision, as the case may be, upon such property if it were not exempt from taxation, with such allowance as may be considered by him to be appropriate for expenditure by the Government for streets, utilities, or other public services to serve such property. As used in this section the term "State" shall include the District of Columbia.

This provision is now Section 306 of the Lanham Act.

Thus it is incumbent upon the Federal Public Housing Authority (to which Lanham Act projects were transferred under Executive Order No. 9070, February 24, 1942) to pay to local taxing bodies, in lieu of taxes, amounts approximating the taxes which would be paid to such subdivisions if they were not exempt from taxation. This applies to all Lanham Act projects, whether of permanent or temporary construction. It is also immaterial what federal agency, prior to Executive Order 9070, originally undertook the particular project involved. The payments are made directly to the appropriate taxing jurisdiction not later than the date on which taxes are normally due.

Two qualifications may be noted with respect to such payments:

1. Provision is made for such deductions as may be appropriate because of expenditure by the federal government for streets, utilities, or other public services to serve such property. In effect, this means that, to the extent that the federal government itself furnishes services for the project that ordinarily are furnished by the community, it is entitled to an appropriate deduction in its payments in lieu of taxes.

2. The Comptroller General of the United States has ruled that the amendment of January 21, 1942, is not retroactive, so that payments made under Public 409 may cover only the period subsequent to January 21, 1942 (Opinion Comptroller General B-26073, June 19, 1942). With respect to the period prior to that date, the Comptroller ruled that payments must be made pursuant to the agreements entered into under the original Section 9. With respect to any projects upon which taxes would normally have accrued prior to January 21, 1942, but with respect to which no agreements were entered into, the Comptroller ruled that no payments whatsoever may be made with respect to the period up to January 21, 1942.

There is some Lanham Act property under the jurisdiction of the War and Navy Departments. Neither Department has apparently made as yet any payments in lieu of taxes with respect to such property, but it is expected that arrangements will be made for such payments.

Temporary Shelter Projects

Under the provisions of Public Law 9, 77th Congress (supplemented by Public Law 73 and Public Law 353, of the same Congress), $320,000,000 was made available "to provide temporary shelter." Under Executive Order No. 9070, such shelter is being provided by the Federal Public Housing Authority. The same Public Law No. 409, which made mandatory the making of payments in lieu of taxes approximating normal taxation for Lanham Act projects, also provided that:

> Any agency designated by the President to provide temporary shelter under the provisions of Public Law Numbered 9, Seventy-seventh Congress, Public Law Numbered 73, Seventy-seventh Congress, or the Third Supplemental National Defense Appropriations Act, 1942 (Public No. 353, 77th Congress), shall have the same powers with respect to the . . . operation, and administration of such temporary shelter as are granted to the . . . Administrator under . . . section 306 of this (Lanham) Act with respect to projects constructed hereunder. . . .

Section 306 is the original Section 9 of the Lanham Act with respect to payments in lieu of taxes, as amended by Public Law 409.

Thus, the Congress has authorized payments in lieu of taxes in the same amount and in the same manner as payments in lieu of taxes with respect to Lanham Act projects. As a matter of policy, the FPHA has determined to make payments in lieu of taxes in connection with all temporary shelter projects upon the same basis as is mandatory with respect to Lanham Act projects.

War Housing Under FPHA

Public Law 671, 76th Congress, is the statute which authorized the USHA (now the FPHA) to use for the provision of war housing, funds available to it under the United States Housing Act of 1937. This Act also authorized the FPHA to revise any contracts for low-rent housing and slum-clearance projects made under the provisions of the United States Housing Act so as to provide that the projects involved will be used for war housing purposes. Thus, the great bulk of the war housing projects being provided under Public Law 671 consists of projects owned and operated by local housing authorities with FPHA financial assistance. With respect to such projects, the FPHA has adopted the following policy:

> Local housing authorities are hereby authorized to make payments in lieu of taxes on all FPHA-aided projects in accordance with the provisions hereunder. The local housing authorities may determine for each project the distribution of such payments among the various taxing jurisdictions, provided that the payments in any year to any taxing jurisdiction shall not be greater than the taxes which would be paid to such jurisdiction if the project were not exempt from taxation, with appropriate allowances, in the case of projects under Public Act,

No. 671, for expenditures by the Federal Government or local housing authority for streets, utilities, or other public services to serve such project. The payments in lieu of taxes made by local authorities in respect to FPHA-aided projects may not exceed the amounts permitted to be paid by local authorities under applicable state or local laws. The amounts to be paid in lieu of taxes in respect to FPHA-aided projects must be approved by the FPHA prior to payment.

Local housing authorities are authorized in respect to any FPHA aided project under Public Act No. 671 to make payments in lieu of taxes which (together with any payments in lieu of taxes contracted for) may equal either (a) Net Revenue before Payments in Lieu of Taxes, or (b) 5% of Actual Shelter Rents, or (c) 1/6 of the difference for any project fiscal year between the maximum amount of FPHA annual contribution permittetd by statute (i.e., annual contribution computed at the applicable FPHA interest loan rate plus one-half of one per cent) and the actual FPHA annual contribution which would be required in such year if no payment in lieu of taxes were to be made, whichever of the three amounts is the greatest, but not in excess of the amount of full taxes less appropriate allowances, if any. Such payments may be made after the end of each project fiscal year, and may be paid in respect to revenues accrued subsequent to January 1, 1942. The payments in lieu of taxes hereby authorized in excess of amounts contracted for, may be made only in an amount which will not reduce the value of the local contribution in any year to less than 20% of the actual FPHA annual contribution.

Net Revenue before Payments in Lieu of Taxes as used above shall mean all Revenues (excluding FPHA annual contributions) of the project, less (a) Operating Expenses (including reserves, but excluding all payments in lieu of taxes), and less (b) Deb Service. Debt Service prior to permanent financing shall mean actual interest accrued plus amortization of the development cost at 0.84% per annum; subsequent to permanent financing it shall, for any year, mean the Bond Service Requirement for such year.

Briefly, this formula, which was necessary because of the fact that the contracts for financial assistance of these projects had to be attuned to the provisions of the United States Housing Act, means that local housing authorities are authorized to make payments in lieu of taxes substantially equal to normal taxes or as much thereof as the revenues of such projects will permit.

Since the projects involved are locally owned, the pertinent statutory provisions are local, so that any statutory limitations upon the payments authorized by this FPHA policy would have to be determined by an examination of the local law.

With respect to the small number of projects directly constructed by the FPHA under Public Law 671, the pertinent statutory provision is Section 13(c) of the United States Housing Act which provides:

> The Federal Public Housing Authority may enter into agreements to pay annual sums in lieu of taxes to any State or political subdivision thereof with respect to any real property owned by the Authority. The amount so paid for any year upon any such property shall not exceed the taxes that would be paid to the State or subdivision, as the case may be, upon such property if it were not exempt from taxation thereby.

Pursuant to this authorization, the FPHA has adopted the policy of making payment in lieu of taxes on the same basis as payments are made with respect to Lanham Act projects to the extent that moneys are available therefor.

Army and Navy War Housing Projects

These are projects authorized by Section 201 of the Second Supplemental National Defense Appropriation Act, 1941 (54 Stat. 872, 883, 884, September 9, 1940), which provided $100,000,000 originally for allocation to the War and Navy Departments for the purpose of acquiring land and constructing housing units on or near military or naval establishments or near privately owned industrial plants engaged in military or naval activities.

Public Law 137, 77th Congress (55 Stat. 361, approved June 28, 1941), provides that:

> The departments, agencies, or instrumentalities administering property acquired or constructed under section 201 of the Second Supple-

mental National Defense Appropriation Act, 1941, shall have the same powers and duties with respect to such property and with respect to the management, maintenance, operation, and administration thereof as are granted to the Federal Works Administrator with respect to property acquired or constructed under title I of such Act of October 14, 1940 (the Lanham Act), and with respect to the management, maintenance, operation, and administration of such property so acquired or constructed under such title.

Executive Order 9070 transferred to the FPHA all property constructed under Public Law 781, except housing units located on military or naval reservations, posts, or bases. As in the case of the Public Law 9 and directly operated Public Law 671 projects, the FPHA will as a matter of policy make payments in lieu of taxes on the same basis as those made on Lanham Act projects.

Apparently the War Department does not now operate any Public Law 781 projects. Also to date it does not appear that the Navy Department has made any payments in lieu of taxes with respect to housing projects operated by it under Public Law 781. It does, however, make monthly payments with respect to such property to local taxing units with respect to services rendered in connection with garbage collection, fire and police protection, school facilities, and the like.

The Military Appropriation Act, 1943 (Public Law 649, 77th Congress, July 2, 1942), under a paragraph entitled military posts, authorizes the Corps of Engineers of the Army to construct buildings, *inter alia,* housing. Under this authority numerous housing projects have been programmed and are being constructed by the Army in a number of States. Such projects, when constructed on or off military reservations, become part of such reservation. The Act makes no provision for payments in lieu of taxes with respect to such projects, and information

obtained from the War Department is to the effect that no such payments are made or contemplated.

Low-rent Housing and Slum-clearance Projects

When USHA-aided low-rent housing and slum-clearance projects were first being planned, following the enactment of the United States Housing Act of 1937, it was, of course, necessary, as a matter of sound administrative policy, to assure that the maximum subsidy possible, both federal and local, would be available if needed for the successful operation of such projects. For this reason, the USHA, in its Contracts for Loan and Annual Contributions with local authorities, agreed to pay the maximum federal subsidy authorized by the federal act. Similarly, it was generally required that the local authority obtain cooperation agreements from the local taxing bodies providing for complete tax exemption of the project. Actual operating experience of these projects has since indicated, however, that the maximum federal and local subsidies are not necessary. Also, the advent of the war resulted in a general increase in income levels so that tenants can pay higher rentals than it was originally anticipated that they could afford. As a result, last March the FPHA adopted a policy providing for a proportionate division of all moneys available for reduction of subsidies between the federal government and the local taxing bodies. Several changes have been made since then with respect to the method for determining the exact division of the moneys available for subsidy reduction between the federal and local governments. The latest statement of policy issued by the FPHA in this respect (October 10, 1942) provides that:

Local housing authorities are authorized in respect to any FPHA-aided low-rent project not under Public Act No. 671 and which was

permanently financed before September 30, 1942, to make payments in lieu of taxes which (together with any payments in lieu of taxes contracted for) may equal either (a) 5% of Actual Shelter Rents or (b) 1/6 of the total amount available (before payments in lieu of taxes) for the reduction of subsidy in any fiscal year, whichever amount is the greater, but not in excess of the amount of full taxes. Such payments may be made after the end of each project fiscal year ending on or after September 30, 1942, and may be paid in respect to revenues accrued from the beginning of such year. The payments in lieu of taxes hereby authorized in excess of amounts contracted for, may be made only out of funds available for the reduction of FPHA annual contributions, and only in an amount which will not reduce the value of the local contribution in any year to less than the sum of 20% of the actual FPHA annual contribution plus a margin of safety equal to 10% of the fixed FPHA annual contribution.

With respect to projects not permanently financed at the time this policy was adopted—that is, projects not financed by September 30, 1942—this policy also provides for

. . . payments in lieu of taxes which (together with any payments in lieu of taxes contracted for) will equal 5% of Actual Shelter Rents from initial occupancy to Bond Date. Such payments may be made after the end of semi-annual or annual periods as determined by the local authority.

This latter provision was necessarily limited to projects not yet permanently financed because of the rights of the bondholders with respect to local contributions for the projects already permanently financed.

As in the case of FPHA-aided Public Law 671 projects, the local housing authorities may determine, for each project, the distribution of the payments among the various taxing jurisdictions. As also in the case of Public Law 671 projects, the payments made in any year to any taxing jurisdiction shall not be greater than the taxes which would be paid to such jurisdiction if the project were not exempt from taxation, and such payments may also not exceed the amounts permitted to be paid by the

local authority under applicable state or local laws. Similarly, the amounts to be paid must be approved by the FPHA prior to payment.

PWA Housing Division Projects

With respect to the so-called PWA projects which were transferred to the USHA, Section 13 (c) of the United States Housing Act, already referred to, also authorizes the payment of sums in lieu of taxes with respect to such projects. In connection with such projects the FPHA has adopted the following policy:

> Local authorities are authorized to make payments in lieu of taxes on PWA Housing Division Projects leased to them, and the FPHA will make payments in lieu of taxes on PWA Housing Division Projects operated directly by it, which payments (together with any payments in lieu of taxes heretofore agreed upon) will equal either (a) 5% of Actual Shelter Rents, or (b) 1/6 of the excess of the Revenues of the project over the Operating Expenses (including reserves, but excluding fixed rent, additional rent, and payments in lieu of taxes), whichever amount is the greater, but not in excess of the amount of full taxes. Such payments may be made after the end of each annual lease period (or federal fiscal year in the case of directly operated projects), and may be paid in respect to revenues accrued subsequent to July 1, 1942. The payments in lieu of taxes hereby provided in excess of amounts heretofore agreed upon, may be made only to the extent that funds are available therefor. If made by a local authority, they shall be distributed by it among the various taxing jurisdictions; shall not exceed the amounts permitted to be paid by it under applicable state or local laws; and must be approved by the FPHA prior to payment.

Farm Security Administration Projects

Prior to Executive Order No. 9070 setting up the National Housing Agency, the Farm Security Administration received $20,000,000 of the temporary shelter Public Law 9 and Public Law 73 appropriation funds. Executive Order No. 9070, however, transferred all such housing to

the FPHA so that the policy adopted by the FPHA with respect to such projects (as indicated above) is applicable to such housing.

With respect to Resettlement Projects or Rural Rehabilitation Projects operated by the FSA, the Bankhead-Black Act (49 Stat. 2036; 40 USCA, Sec. 431 *et seq.*) authorizes payment in lieu of taxes as follows:

> Upon the request of any state or political subdivision thereof, or any other local public taxing unit, in which any such project, described in section 1 (§431 of this title), has been or will be constructed, the Resettlement Administration is authorized to enter in an agreement, and to consent to the renewal or alteration thereof, with such state or political subdivision thereof, or other local taxing unit, for the payment by the United States of sums in lieu of taxes. Such sums shall be based upon the cost of the public or municipal services to be supplied for the benefit of such project or the persons residing on or occupying such premises, but taking into consideration the benefits to be derived by such state or subdivision or other taxing unit from such project.

The Act also provides that:

> The receipts derived from operation of such projects, in addition to the moneys appropriated or allocated for such projects, shall be available for such payments in lieu of taxes and for any other expenditures for operations and maintenance (including insurance) of such projects. . . .

With respect to these purely farm projects which were not transferred from FSA and which it now manages and operates, since the Act requires that the amounts to be paid must be based "upon the cost of the public or municipal services to be supplied . . . taking into consideration the benefits to be derived by . . . taxing unit from such project," it is necessary, with respect to every such project, for findings of fact to be prepared, based upon economic justification showing compliance with the statute. The Comptroller General has ruled that the responsibility for taking into consideration the factors

required by the statute must necessarily be primarily that of the Secretary of Agriculture (21 Comptroller General 74, 1941). In practice it has been found that the amount of the payment is actually comparable to the amount which otherwise would be payable as taxes if the property were subject to taxation. Such payments are timed to the fiscal year of the taxing unit involved.

Defense Homes Corporation

The Defense Homes Corporation has adopted the policy of making payments in the amount equivalent to the amount of taxes which would normally be assessed.

Distinctions in Tax Status of War Housing and Slum-clearance Projects

In order that no confusion may arise because of the policy of payment of full taxes on "war housing projects" with a different formula for payments in lieu of taxes on slum clearance projects the following distinctions are submitted:

1. War housing projects are generally constructed in communities expanding as a result of the location of war industries in the community. This expansion places new and additional burdens upon the community since it must provide necessary municipal services for the in-migrants. It is, therefore, appropriate for the federal government to make payments approximating normal taxation so as not to place upon individual communities burdens due to the national war effort. For the same reason it has been appropriate for the federal government also to make grants-in-aid to provide the capital cost of buildings and facilities such as schools, water works, etc., made necessary by the large influx of in-migrants. Low-rent housing and slum-clearance projects, in contrast, are designed to serve those who have always lived in, and been a part of, the community and to whom the municipality has always been furnishing community facilities and services. Such projects, therefore, do not involve the increase in burden that is pres-

ent in connection with war housing projects, and do not involve taking care of "outsiders."

2. War housing and low-rent housing projects are designed to serve two altogether different income classes. War housing projects will normally serve those in an income class who have always contributed their full share toward meeting the local tax burden. Members of this income class should continue to meet their share of the tax burden. Tenants of low-rent housing and slum-clearance projects, however, consist of families with low income coming from the slums of the community who have never been able to bear their proportionate share of the tax burden, and who at the very same time have also involved a great drain on the revenues of the community because of the high cost to the community of its slum areas. Such projects, therefore, are only serving families whom the community has always had to serve at a substantial loss, and whose incomes have never permitted them to bear their ratable share of the tax burden. In fact, the latest FPHA policy on payments in lieu of taxes, which contemplates that tenants will bear their share of the tax burden to the fullest extent consistent with their income, may mean an increase in revenue to the city from such families. At the same time, the removal of such families from slum conditions means a substantial saving to the city in the cost of the municipal services relating to fire, police, health, etc., with respect to such families, as compared to such cost when they lived in slum dwellings.

3. War housing projects are projects which are owned by the federal government and in which the local community has no proprietary interest. Low-rent housing and slum-clearance projects, on the other hand, are projects owned by the local community in which the municipality, acting through its agent the local housing authority, always has beneficial title and will have full title as soon as it has paid off the capital loan on the project.

4. War housing projects are, as an integral part of the war program, basically for a national purpose. The provision of such housing represents a federal program for a federal purpose with respect to which the local community is assisting the federal government. The converse is true with respect to low-rent housing and slum-clearance projects. These represent projects undertaken by a local public body for the benefit of the local community to eliminate the evils resulting from the slums in that community. The role of the federal government in this case is merely to give assistance to the local community in coping with the problems due to local slum conditions.

5. By very definition, low-rent housing and slum-clearance projects could not exist without subsidy since they are designed to serve those

families who could not afford decent, safe, and sanitary dwellings provided by private enterprise. The most convenient means for the local community to provide a subsidy is by tax exemption. If the local community does not wish to provide a subsidy, the following alternatives are present:

a. That the federal government furnish the entire subsidy. This is impossible under existing federal legislation which provides that any federal subsidy for a *local* project must be complemented by *local* subsidy in the form of tax exemption or cash.

b. That the local community abandon any hope of dealing with the evils arising from its slum areas.

6. With respect to the hundreds of projects already in existence, removal of tax exemption would mean either that the present tenants would have to be evicted and families of much higher income served, thus providing competition with private enterprise or that the federal government take over these projects, in which case they would be exempt from taxation in any event as federal property and would be the property of the federal government and under its sole control.[6] It would also jeopardize the payment of the bonds issued by the local housing authorities to finance the capital cost of the project, since without the federal annual contributions, which cannot be made in the absence of tax exemption, it would, as a practical matter, be impossible for the local housing authority to avoid default on the bonds. This might be very damaging to the credit standing of the communities involved. In addition, it would do injury to those who had relied upon the good faith of the community in purchasing the bonds. The absence of tax exemption would also prevent the sale of further bonds with respect to any project and, therefore, make it impossible to finance any future projects.

7. Tax exemption makes it possible for the local community to receive a federal cash subsidy which may amount to as much as five times the value of the local subsidy. It would be poor administration for the local community to reject substantial federal assistance to clear the slums in the community, because such assistance is condi-

[6] On November 24, 1942, the Federal Public Housing Authority announced that arrangements had been completed for the taking over of $60,000,000 of slum-clearance projects in Ohio on April 1, 1943, unless some means is found to provide tax exemption. This will mean that, unless legislative or judicial relief permitting the resumption of tax exemption can be obtained by that date, such projects will become federal property, thus automatically removing them from local tax rolls. Such action was made necessary by the decision of the Ohio Supreme Court that slum clearance projects, owned by local housing authorities, are not tax exempt. *Columbus Metropolitan Housing Authority* v. *Thatcher*, 7 *Municipal Law Journal* 84, 140 O. S. 38, 42 N. E. (2d) 437 (June 3, 1942).

tioned upon the community's not taxing its own property being operated for its own benefit.

8. It should be noted, in connection with the new policy on payments in lieu of taxes, that, should the incomes of tenants increase so as to make it possible for them to pay higher rentals, the amount of payments in lieu of taxes will automatically also increase. Accordingly, the community is assured that tenants of low-rent housing projects will always bear to the fullest extent possible their share of the tax burden.

Other Departments of the Federal Government and Payments in Lieu of Taxes

Aside from the housing projects referred to above, there is no provision for payments by the Army and Navy of either taxes or payments in lieu of taxes on any of the 30,000,000 acres acquired by these federal departments since the attack on Pearl Harbor—or for that matter, on land acquired by the Army and Navy at any other time. Some action in this field may be expected at an early date, as it is reported that the federal Budget Bureau is making a study of this matter—it seems that the Budget Bureau's study is independent of the work of the Federal Real Estate Board, referred to in a later part of this paper.

As already indicated herein,[7] there has been much legislation authorizing various federal departments and agencies to make payments of taxes or payments in lieu of taxes to state and local governments. The Department of Agriculture and its Farm Security Administration, Forestry Service, and Soil Conservation Service make payments in lieu of taxes to local governments under the authority of various federal statutes. The Department of the Interior makes payments in lieu of taxes out of receipts of its Fish and Wildlife Division from commer-

[7] *Supra*, footnote 4.

cial activities on migratory bird refuges. This particular statute [8] provides for payments to counties of 25 per cent of such receipts for school and road purposes. Certain royalties received from private individuals mining ores on public lands are, under federal statute, shared with states in which such lands are located.[9] Other statutes give states a share of other revenues collected by the Department of the Interior from grazing and similar privileges which are paid for by private persons. Among the recent statutes is that authorizing the payment of $300,000 per year to the states of Arizona and Nevada out of the sale of electric energy on the Boulder Dam project.[10]

The Tennessee Valley Authority was at first required to pay 5 per cent of its gross proceeds from the sale of electric power generated within Tennessee and Alabama to these states,[11] but a later Amendment [12] provides much more generous payments. The Amendment also provides that all states in which the Authority owns property and carries on power operations shall receive payments. These payments in 1941 were 10 per cent of the gross receipts of power sales instead of the original 5 per cent. The Federal Power Commission pays states 37½ per cent of receipts of the Commission from licenses for the use of federal land under its jurisdiction.[13] Real estate owned by national banks has been subject to state and local taxation since 1864.

A large number of corporations created under the Reconstruction Finance Act, as pointed out above, all pay

[8] 49 Stat. 383.
[9] 41 Stat. 450.
[10] 79 Stat. 1542.
[11] 48 Stat. 58.
[12] 54 Stat. 611, 626.
[13] 41 Stat. 1072, 49 Stat. 845.

full taxes on real estate they acquire. The Federal Deposit Insurance Corporation, the Federal Home Owner's Loan Bank Administration, the Farm Credit Administration and the Home Owner's Loan Corporation all pay full taxes on real estate to which they hold title. The HOLC claims to be one of the largest real estate taxpayers in the country.

Federal Legislation

The Congress has not been unattentive to the need of cities for payments in lieu of taxes on real estate taken over by the federal government. The Lanham Act Amendment referred to above demonstrates the most recent congressional policy. Other bills have been introduced in the Congress and a brief review of some of them will illustrate the problems and suggested Congressional solutions.

Taxation of Federal Real Property by Cities and States

Representative James W. Mott of Oregon has introduced a bill (H.R. 6903) providing for taxation by the states and their political subdivisions of certain types of real property acquired for military purposes. This bill is aimed to recover taxes for states which are now lost as soon as the government takes over the property. The bill, now before the Committee on Public Lands, would include all real property in the continental United States which is acquired by purchase, condemnation, or otherwise, by or on behalf of the United States for general military purposes, together with improvements. Such property "shall remain subject to taxation by the State and political subdivision in which such property is lo-

cated, to the same extent, according to its value, as other real property,'' the bill states. The measure would not apply, however, with respect to property where such power of taxation is waived in accordance with state law.

Taxation of Army Property

On July 2, 1942, the Senate passed a bill (S. 2308) providing for continuation of state and local taxes on property acquired by the United States for designated military purposes. This bill was referred to the House Military Affairs Committee on July 6, 1942.

Taxes on Real Property Acquired by the United States

On September 14, 1942, Senator Pepper introduced a bill (S. 2777) providing for taxation by states and their political subdivisions, for the liquidation of any bonded indebtedness, of real property acquired by the United States in the same manner as other real property is taxed. The idea back of this legislation seems to be that with the federal government acquiring large tracts of land, many political subdivisions must raise their tax rates in order to pay for bonded indebtedness secured by tax levies to take care of the loss of revenues from land taken over by the federal government, and the proposed legislation would prevent this.

In addition, the Congress refused to pass upon the proposed bill (H.R. 6955) to give tax exemption to materials used in performing war contracts. This bill had been proposed to escape the effects of the decision in *Alabama* v. *King and Boozer*, 314 U. S. (1941), that without federal legislation making the purchase of such

materials exempt from state and city taxes, those taxes must be paid by federal contractors even though the effect of such payment increased the costs of the federal government on cost-plus-a-fixed fee contracts.

Federal Real Estate Board

On January 14, 1939, the President by Executive Order No. 1939 created the Federal Real Estate Board, and charged the Board with the duty of making a study of the tax problems created by federal ownership of real estate for all purposes. The Board is to make recommendations to the President on future federal policies as to payment of real estate taxes or the making of payments in lieu of taxes on all federally owned real estate. This Board advises that its report and recommendations will be presented to the President in February, 1943.

Conclusions

It is apparent that the rapid increase in federal ownership of real estate and the resulting removal of such real estate from city and state tax rolls has created problems of great national concern. The Congress by legislation and the President by use of his executive powers have both given their attention to these problems. In the public housing field a fair solution has been arrived at in recent weeks, providing for full payments where the project is primarily for the national benefit, and for the highest possible payments consistent with the purposes of the project and the benefits to be derived by the local community in connection with slum-clearance projects, but in other fields no solution has yet been announced.

Payments in lieu of taxes are the best solution to the problems created by tax exemption of federally owned real estate and the future undoubtedly will see an increasing use of such payments to spread the burden of the cost of the national government equitably over the entire nation.

PART FOUR

SHAPING FISCAL POLICIES TO AID IN POSTWAR ADJUSTMENTS

CHAPTER X

PLANNING POSTWAR CAPITAL IMPROVEMENTS

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HAD I much of the caution normal to a person engaged in public service I would label this an "off-the-record" paper. For it has become almost high treason to propose any work that is not a direct part of waging war. Conscious now of having traveled too long and too far the road of peace, we have turned perhaps too completely in the other direction. As once blinded by love of peace, we now seem blinded by the exigencies of war.

But even through the confusion of battle it must now or soon be seen by all thinking men that this is a war of economics as well as of guns—that the biggest and most difficult fight will come after the last gun has been fired. This fight will be on the field of depleted treasuries, diminished natural resources, threatened unemployment, and world-wide social unrest.

It is as important to conquer the aftermath of war as it is to win the war. To do so, the same careful preparations must be made as for a war with guns. These preparations include much planning on a wide front—planning that must be done concurrently with waging war, planning that must be done now. Plans for peacetime action must be ready to go the day peace is declared.

After peace there will be little time for making plans—too much confusion in any event to do the kind of planning that should be done.

This paper is concerned with only that sector of planning having to do with postwar capital improvements. This planning has three phases: (1) the preparation of over-all plans by the individual units of government, and the coordination of plans made and projects proposed by individual governmental units and agencies—for the principal purpose of assuring sound projects and of avoiding wasteful duplication of and conflicts between improvements; (2) the preparation of construction plans and specifications for first-order projects as a backlog of ready-to-go projects comprising an effective public works reserve; and (3) the building of cash or credit reserves to finance the public improvements when the time comes to make them.

Preparation of Over-all Plans

A planned public works reserve has two principal objectives. The first is to abate unemployment while industry is being reconverted from wartime to peacetime production. The other is to provide an ordered program for postwar public construction to meet the wartime accumulation of deficiencies in public improvements and services.

Many maintain with reason that in the postwar release of dammed-up consumer demand there are the makings of a new and unprecedented prosperity. To be reckoned with, however, is the unavoidable time lapse between all-out production of munitions and full-scale production of consumer goods. It took months under extreme pressure

to tool industry for making guns, planes, and ships. It will take even longer to reconvert the industrial plant as a whole for peacetime production.

About twenty million people are already directly engaged in the armed forces and in the production of munitions. Millions more have been diverted from normal peacetime work. The army is still in the making, and war employment is still on the increase. What is to happen when the war factories close their doors and the army comes home to resume its promised civilian jobs? A gradual demobilization of the army and of war workers would ease the shock of transition from war to peace, but it is an unlikely expedient. When war is done the people of the United States will be done with war. They will approve whatever police-force army may be required by the circumstances of peace but will refuse to pay for guns and ships obviously to be scrapped, and will resent any proposal to keep their sons and husbands in the army a day longer than is required by war.

Probabilities are, therefore, that during the first few months following declaration of peace, from a third to a half of the employables of this country will be looking for new jobs. For those industries making goods equally useful in war and in peace, the shift-over will be comparatively easy and quickly done. But for the great bulk of the war industry, the change back to peacetime production will require complete retooling and extensive reorganization—a matter of months or years. At best, many millions of people will be out of usual employment for a period of six to eighteen months, and will be unemployed during the period of great unrest that must follow this war.

The prophets of after-war prosperity count heavily upon the war savings of the people to prime the pump of postwar production and consumption. But idle time, too much prolonged, will dissipate whatever wartime savings may escape wartime taxes. A few months of large-scale unemployment will so reduce potential purchasing power that when consumer goods finally start coming from the assembly line there will be no money with which to buy them. While not an economist, that kind of a situation would seem to me to contain more of the seeds of depression and revolt than of prosperity. And it suggests that the first great postwar problem will be that of bridging the gap between wartime and peacetime employment, with solution lying chiefly in: (1) hastening the reconversion and reorganization of industry; and (2) providing stop-gap employment through means like a great public works program.

Blueprinting Specific Projects

We have suggested that, at the end of the war, there will have accumulated a deficiency in public improvements corresponding to the accumulated deficiency in consumer goods. There exists a rapidly increasing body of needed public works sufficient, if properly planned and organized, to provide a large volume of stop-gap employment without resort to the kind of made work that characterized the early thirties. But for the most part, the projects comprising this body of potential improvements are still in the dream stage. New highways, new housing, new disposal plants, and new parks are known to be needed approximately here or there, but, for the most of them, the necessary construction plans and the neces-

sary lands are still lacking. The nation's public works reserve is still too small and too ill-prepared to have force as a depression preventive. As things now stand, it will take longer to get a full-scale public works program into operation than it will take to reconvert the war industrial plant. Months and years of planning must go into the public works reserve before it is ready for use as a tool for the abatement of unemployment.

Lacking in the present works reserve are not only the construction plans and lands for individual projects, but, also, the desirable integration and coordination of plans and projects. There has been much too little comprehensive planning at any level of government for proper visualization of long-term development goals and for determining the proper interrelationship and sequence of improvements. Most present work programs are hit-or-miss affairs containing many extravagant pet projects and "letters to Santa Claus." There has been even less effort toward regional coordination of the plans of individual units of government and, as a result, much overlapping, conflict, and duplication of projects.

While the first purpose of a postwar public works program may be that of providing stop-gap employment, we shall have lost an opportunity and committed a social and financial blunder if we do not provide that this program shall also produce useful improvements. Getting a dollar's worth for every dollar spent on this program should be more than an incidental objective. Foolish projects, projects that stand in the way of one another, and projects built before their time, will provide employment as well as any others. But can we afford them? Can we or will we afford the foolish projects and the good ones too?

Or shall we relinquish the really needed improvements and services because we have planlessly precommitted our available resources and public funds to an ill-conceived program?

Thus far we have been talking about the usual public works—streets and highways, utilities, airports, parks, and public buildings—comparatively small in total employment potentialities but sufficient we believe to take up considerable slack in immediate postwar unemployment. We have accepted the current expectation that, once the machinery of peacetime production gets rolling, an enlarged consumer demand will keep that machinery moving at an increasing tempo to produce an unprecedented national prosperity. But we have our reservations as to how long that new prosperity can survive unless great new sources of employment are evolved to supplement the production of what are usually regarded as consumer goods.

By means of the greatly enlarged industrial plant using newly discovered production processes, faster and more efficient, it will be possible in after-war years to produce more goods with fewer men than ever before. Should we inflate usual demand, to place two automobiles in every garage, and two bathtubs, two radios, and two refrigerators in every home, we shall but only slightly prolong the day when the factories are turning out more goods than we can use or persuade other nations to buy. We may revolutionize the hours of labor—reduce them from forty to twenty hours a week—only to come soon again to having millions of able workers unhappily and restlessly idle, unless we find new gainful work for men to do.

Potential Capital Improvements

The greatest and most satisfying untapped source of employment is in improving man's environment and the physical circumstances of his earthly existence. The job includes giving every family a decent house in decent surroundings, rebuilding outmoded cities, and providing a vast range of new facilities and services important to better living. Fantastic? Perhaps a little! But not nearly as fantastic as will be the results of recurring and ever-deepening depressions or the catastrophy of another world war. Neither does the prospect seem so impossible when broken down into its parts. Stuart Chase estimates that the labor and the labor income lost through unemployment during the nineteen-thirties was more than sufficient to build a new $6,000 house for every family in the United States. Without question, we have the materials and the manpower to revolutionize man's physical environment, including rebuilding his cities. We need only to want to do these things as we want now to win the war—want to do them enough to devise the organization and the financial and legal means for their accomplishment.

Here then are the short-range and the long-range views of potential postwar capital improvements and public work. The one is directed toward a program of most-essential public works susceptible to telescoping within the immediate postwar period for stop-gap employment. The other is directed toward stabilizing the peace through the years by minimizing chronic unemployment and by removing some of the circumstances of present-day living that engender social unrest and war. Both require intelligent planning. The first planning job, of course, is to

prepare the immediate public works program. But even that program will lose much unless made with the longer view. The improvements made year by year should somehow be made to fit ultimate objectives. It may be possible, sooner or later, to find the manpower, the materials, and the money to rebuild our cities and transportation systems several times, but, as the Tax Institute can especially well appreciate, it will simplify matters for this and the next few generations not to have to duplicate even so pleasant a task.

Financial Planning for Postwar Program

This brings me to the third planning job coming within the scope of this paper, that of assuring the financial means for making the needed postwar improvements at the time and at the rate required to supplement private employment. And here, perhaps, I should give the floor to the taxation and financial experts. I have stepped boldly far into the field of the economist because I have assumed him to be well away in his wartime home in Washington. But here, I hope I shall not have the temerity to explore much beyond the hedgerow boundary between city planning and public finance. Perhaps I shall content myself with lobbing a few ideas over the fence to see what you will do with them.

The first suggestion has to do with postwar public works programming and budgeting as distinguished from making plans. First we make the comprehensive plan. From this plan, we select individual projects in the order of their timeliness and importance. At about the same time we start making construction plans and cost estimates for individual projects as selected from compre-

hensive plan. Then comes shaping the total body of projects into some kind of working program. And in doing this I should like to suggest departure from the usual long-range programming and budgeting procedure as only recently recommended by Washington. Rather than group projects by years for construction, over a five- to ten-year period, I would throw all projects into a single list, indicating only the order in which they are to be built, and not bothering too much at the moment about where the money is coming from. As an effective tool for unemployment relief, the public works program must be very elastic. Quite likely it will be necessary or desirable to compress a normal five- to ten-year construction program within the first eighteen postwar months. So there isn't much point now in going through the process of designating projects by years over a longer period of time. Finally, a public works program of effective proportions will require special financing including an undetermined amount of federal aid. Until there is decision as to how and by whom the postwar program is to be financed, there is little point either in going through the laborious process of preparing the long-term capital improvement budget. This is not to belittle the value of long-term capital improvement programming and budgeting in normal times. I am thinking only of the immediate postwar requirements. Nor do I want to suggest that the states and localities can safely disregard the question of financing postwar improvements.

No matter what the degree of federal aid in the postwar works program, there will be some considerable balance of cost to be met by the localities. Furthermore, no matter what the financial expediencies evolved to effectuate the postwar program, the states and localities must

ultimately foot the bill through some form of taxation, for they comprise the federal government. It is important, therefore, that the states and localities act now toward creating reserves of credit, cash, and land, for postwar use.

Credit reserves are to be accumulated by retirement of debt and by restraint from further borrowing during the period of war. Creating cash reserves in most states may require special legislation. New Jersey enacted a bill this year empowering municipalities to create cash reserves through taxation, the funds to be invested in bonds of the United States and to be spent in any year following the war. A thus far unsuccessful effort is being made in the same state to have the state government put by a fifty-million dollar reserve for postwar construction. Land reserves comprised of lands needed for postwar improvements may prove even more useful than cash reserves in getting projects quickly underway. Many municipalities and some states have large nuclei of public land reserves in the form of tax-forfeited lands. Usually, at least some of the tax-lien lands can be used most advantageously for needed public improvements. Planning studies should be made to determine which of these lands have public usefulness and are, therefore, to be held in public ownership.

Conclusion

In conclusion I should like to re-emphasize the importance of doing now whatever of planning there is to be done. The war may go on for years. But it may end in 1943. Planning takes time and there is much planning to be done before we will have achieved a dependable

works program. Right now we are little better prepared to launch a creditable public works program than we were in 1934. And none of us will quickly forget the shameful and degrading wastefulness of that time. Many planning decisions, particularly in social and economic matters, must be deferred until the end of the war when the conditions and the circumstances of peace are known. That is not true, certainly not true in the same degree, of most planning for public improvements. Nor is it true of some financial preparation to pay for postwar improvements. As long as people may be expected to go on living and working in cities and on the land, planners can visualize no end of useful improvements. It may be that after-war plans would be better, but planning then will be too late. To say that fighting must come first is no excuse for not planning now. No one wants to prolong or aggravate the war by deflecting essential energy from the war effort. But that does not seem to me to be in question. This nation has the manpower and the resources to fight and do a little planning too. This nation is great and powerful enough to win the war without having to risk losing the peace.

CHAPTER XI

FINANCIAL PREPARATION FOR POSTWAR PUBLIC WORKS

Harvey S. Perloff

Economist, Board of Governors of the Federal Reserve System

The idea of providing for periods of adversity during prosperous periods goes back at least to the time of Joseph and his "stockpiling" during the seven fat years for the lean years to follow. The modern version is the concept of setting aside in prosperity postponable public works for periods of depression. In wartime there are, of course, additional reasons for postponing nonessential construction.

The desirability of preparing now for postwar capital improvements is universally accepted and has been strongly urged by official groups. The Council of State Governments has recommended that state and local units: "Prepare to offset possible postwar depression by developing programs and blueprints for public works and services, and by accumulating means of financing them." The following means are suggested: Restrict expenditures, maintain tax rates, pay off debts, build up reserves, and sterilize such reserves in dormant bank deposits and in federal government bonds.

The Municipal Finance Officers Association has urged, among other things, that:

1. Finance officers should study the effect of their current decisions with respect to the adjustments that must be made following the close of the present War.

2. Plans should now be made and prepared in detail for Post-War public improvements, and

3. The financing of necessary public improvements in the Post-War period may be facilitated: (a) by the progressive reduction of State and Local Government debt to the end that credit will be available through improved borrowing power, and (b) the exercise of operating economies to the end that reserves or surpluses may be created and that where needed, legislation should be enacted in all states and provinces to accomplish this purpose.[1]

Tax Rates

Although the information now available is incomplete, it is evident that adherence to these principles by the individual states and localities is far from universal. Tax rates have been increased in some instances and reduced in others; the general tendency, however, is to maintain existing rates. Perhaps the most important reduction was the 25 per cent decrease in the New York State personal income tax. Mississippi also reduced its income tax rates, as did South Dakota; the latter reduction causing a decline of about 33 per cent in collections from this source. Illinois has lowered its general sales tax rate, while Indiana reduced the rates of its gross receipts tax. On the other hand, Massachusetts has provided for an additional surtax of 3 per cent on personal income taxes, on legacy and succession taxes, and on certain corporation taxes. Rhode Island has enacted a new gift tax, has raised the tax rate on corporate excess, and has levied a tax upon unincorporated business. Of major importance is the fact that in a number of states there is serious agitation for reduction of taxes and such reductions are contemplated officially.

[1] Resolutions adopted at the Municipal Finance Officers Association meeting at Buffalo, N. Y., on June 22, 1942.

SURPLUSES AND DEBT REDUCTION

The limitations on capital outlays and the sharply reduced relief costs, together with the favorable trend in tax collections, resulted in an operating surplus for fiscal 1942 in a considerable number of states. In some instances the surplus was substantial. New York ended the 1942 fiscal year with an accumulated surplus of $54,000,000, including $7,000,000 carried over from the previous year. California reported a general fund surplus of roughly $14,000,000, in contrast with a deficit of nearly $62,000,000 in the previous year. Wisconsin reported a general fund balance of $31,000,000—the highest in the history of the state. Fairly substantial general fund surpluses were reported also in Colorado, Connecticut, Illinois, Indiana, Kentucky, Maryland, North Carolina, Oregon, Tennessee, and Virginia. A number of states, however, had negligible surpluses and a few reported deficits which, as in the case of New Jersey, will be carried into the budgets for 1943.[2]

The general improvement in state finances within recent years has resulted in a reduction of debt. Total indebtedness of the 48 states, including obligations of state institutions and agencies, amounted to $3,211,000,000 as of June 30, 1942, compared with $3,526,000,000 in 1940. The debt was reduced $113,000,000 in fiscal 1941 and $202,000,000 in fiscal 1942. In certain states, however, indebtedness was increased during the last year, and in Pennsylvania and South Carolina the increase was substantial.

A number of the states are planning to employ current surpluses in the reduction of their debt. Virginia has

[2] Leo Day Woodworth, "State Tax Collections, Monthly, 1942," *Bulletin, National Tax Association*, XXVIII (October, 1942), 11-13.

adopted a noteworthy program for paying off its entire debt. It has set aside \$10,000,000 in addition to other sinking fund assets to be invested in federal securities maturing in those years in which its debt falls due. A few other states are purchasing federal securities for the same purpose.

Rosina Mohaupt, in a study of the bonded debt of 286 cities as of January 1, 1942, reveals that during 1941 outstanding net debt was decreased by 4.6 per cent. This reduction is in line with the downward trend of municipal debt during the last five years.[3] In the past year there were relatively few new municipal issues, but it is too early to determine whether total local indebtedness has been further reduced.

Postwar Reserves

To my knowledge, only a few states have thus far explicitly established postwar reserves. Minnesota has set aside funds for highways, school programs, and small-unit housing construction. The New York legislature has established a postwar capital reserve fund into which it is contemplated that various monies from bond issues and general fund surpluses will be placed, accumulating to an eventual total of about \$300,000,000. Virginia is setting aside funds for specific projects. Henry F. Long reports that a state public works reserve fund is "in the embryonic state" in Massachusetts.

Nine states have authorized certain of their subdivisions to create reserve funds for future public works. Ambrose Fuller, who has prepared a comprehensive report on the subject of municipal capital reserves for the

[3] *National Municipal Review*, XXXI (June, 1942), 316.

American Municipal Association, points out that although the majority of these states—namely, New York, Michigan, Washington, Kentucky, New Jersey (and Massachusetts)[4]—adopted their reserve fund laws in 1941 and 1942, the legislation is not a war idea. Oregon adopted a law of this kind in 1931, California in 1937, and Nebraska in 1939. "Thus it would seem," Mr. Fuller writes, "that this type of legislation has been deliberately conceived as a phase of the development of municipal fiscal policies, as a means of avoiding the pitfalls of traditional long-term borrowing which have so often embarrassed municipalities in the past, and as a phase of the trend toward pay-as-you-go financing."[5]

It should be clear that without permissive legislation, localities—with the exception of "home rule" units—cannot legally accumulate cash reserve funds ("bootleg" reserves are not unknown). Specific or general authority must be found for tax levies. If levies are sufficient to produce a surplus, authority is usually needed to permit its being carried over from year to year, otherwise surplus funds must be reappropriated in the following year's budget. These requirements prevent the establishment of public works reserves out of either special levies or surpluses without permissive legislation. State legislation is necessary also to safeguard reserve funds in order to prevent their dissipation for other purposes.

As far as I know, no considerable use has been made thus far of the state enabling acts, but reports indicate that the present interest in the subject is greatly in-

[4] Mr. Fuller does not mention the Massachusetts permissive law which is a temporary war measure but is similar in general effect to the other state laws.

[5] Ambrose Fuller, "Legislative Authorization for the Creation of Capital Reserves for Future Municipal Outlays," a memorandum prepared for the American Municipal Association, Series AM, No. 26, July 1942, p. 6.

creased in the states which have authorized the creation of local reserves, and that many additional funds may be expected to be established under these laws.

Federal Securities Available for Investment

When funds are to be set aside either for the future liquidation of debt or as reserves for postwar public works, the problem of desirable investments arises. On the whole, it would seem that state and local investment needs are well covered by Treasury offerings. For example, long-term securities are available for unspecified amounts at the very attractive interest rate of 2½ per cent and are being offered every few months. These bonds are issued in denominations of $100 and up to $100,000. An attractive issue is also available for the short-term investment of cash balances. These notes (Tax Series C) mature in 3 years and—as in the case of War Savings Bonds, Series E—interest accrues on a graduated scale. They yield approximately 1.07 per cent per annum if held to maturity. Since there is provision for cash redemption with interest at any time after six months, the problem of sale price (i.e., the possibility of market loss) is removed. There are, of course, a number of other long-term and short-term federal securities which meet the investment needs of state and local governments.

The Current Picture

Thus, the situation with regard to financial preparation for postwar public works appears as follows: The early war boom swelled most state and many local treasuries. This was due mainly to increased tax yields, although

some reduction in expenditures also took place, chiefly because of the sharp drop in relief costs and because of the shortage of materials and personnel and restrictions on construction. Although to citizens accustomed to depression deficits the surpluses looked large and resulted in a clamor for tax reductions, they were by no means large enough in most instances to put finance officers at their ease concerning their finances in the next few years. Indications are that revenues generally are falling off because of gas and tire rationing, shortages of goods, and so on. In addition, a large number of municipalities are finding it extremely difficult to avoid expenditure increases under current conditions, because of increased services called for by the war plants and workers and civilian defense needs; their revenues are not increasing in anywhere near the same ratio. It is not surprising, then, that under present conditions state and local governments, with few exceptions, have not put aside any substantial sums for postwar public works.

The Problem of Cyclical Fluctuation

It is important to go beyond an examination of the current problems and policies of individual units to an analysis of the underlying factors involved in counter-cycle fiscal action at the state and local levels.

Ours is an economy of violent fluctuations, as evidenced by the fact that national income can drop as low as $45,000,000,000 and rise as high as $135,000,000,000 (estimated for 1943), or a ratio of one to three—in current prices—within just about a decade. If we examine previous fluctuations in capital outlays, we get an idea of the magnitudes which might conceivably be involved in

an attempt to stabilize state and local public works over the business cycle. Expenditures for new construction from state and local funds, which averaged over $2,100,000,000 between 1925 and 1929, fell to $707,000,000 in 1933 and reached a low of $616,000,000 in 1935, or less than one-third of the 1925-29 level. The gap was filled to a certain extent by federal grants and loans. According to Census figures, the proportion of total state and local construction that was federally financed rose from 3.3 per cent in 1928 to 69.0 per cent in 1936.

It is widely accepted that in certain periods after the war private construction and private investment generally may be inadequate to maintain full employment. The government will be called upon to fill the gap with expanded public works and services. Certain of the programs will, of course, be federally sponsored, but it is generally agreed that it would be highly desirable if the states and localities themselves planned and financed the great bulk of their capital improvements.

If the state and local governments are to have the tools with which to manage the problems involved in fiscal adjustment to an economy of wide fluctuations, certain improvements in their financial mechanisms and structures would seem to be called for.

Long-term Capital Programs

Physical developments and capital improvements in a state or locality can be undertaken in a sound and rational manner only within the framework of a carefully prepared, long-range program. The foundation for such a program consists of the following: (1) studies of population and economic trends within the community and

within the region; (2) a so-called "master plan," which is essentially a comprehensive picture of physical goals, a picture of what the residents want their community to look like; and (3) analysis of individual projects—how they fit into the "master plan," estimates of costs, time required to build, amount of on-site labor to be employed, and so on. Upon such a foundation, individual projects can be fitted into a logical, balanced, and *flexible* program. In essence, a long-term program of capital improvements is an estimate of capital needs for the next six years or other appropriate period, made up of new facilities, additions, or expansions judged to be necessary by the probable growth of population, as well as replacements that will become necessary because of depreciation and obsolescence. A distinction is made between construction that is postponable and that which is not. Each year the program is reconsidered, revised, and extended a year further into the future.

A long-range capital program provides a sound foundation for flexible fiscal policy. Fiscal decisions must, obviously, be made on the basis of long-term considerations. Tax policy as well as debt policy has to be made on the basis of judgments concerning future developments. The more exact the information on which these judgments are based, the wiser the fiscal policy may be. For example, a municipality proceeding on a year-to-year basis may have taken the easy course of refinancing maturing debt over a long period of time, and, then, rather suddenly discover that large capital outlays are seriously needed, but that it is in no position to finance them. The fact is that taxation is always difficult and always resisted. When budgeting of capital expenditures is on a year-to-year basis, surpluses, even in the most prosperous

years, are difficult to obtain and even more difficult to hold on to. When future capital as well as service needs are clearly presented, long-term financial planning becomes a logical and indispensable corollary.

Counter-Cycle Budgeting

Counter-cycle budgeting is necessary to implement the long-range flexible planning of capital outlays. This involves conscious budgeting of surpluses in periods of prosperity. Questions arise immediately as to how one recognizes prosperity, and what is to be done about prosperity periods that are short-lived. There are no ready answers to either question. The problem of economic fluctuations, however, is with us whether we like it or not, and we have no choice but to do the best we can to make the proper adjustments. Uncertainty cannot be removed, but we can narrow its range. One thing that can be done is to move the voting of the budget and tax collection as close together as possible. Another device, which has already proved its worth, is to establish a competent planning agency to study such problems as the relationship of the community to developments within the industries located in the area and to developments in the national economy, and population and economic trends within the region. Such an agency, working with national and regional planning groups, state and local officers' associations, and possibly an expert federal-state commission, can supply data which may serve to take some of the guesswork out of fiscal planning. Finally, the suggestion might be ventured that positive concerted action to combat cyclical fluctuations may be counted upon to bring about greater stability in the economy, with the

difficulties involved in adjustment being progressively eased.

The collection in periods of prosperity of more taxes than are needed to cover current outlays would help state and local units to maintain expenditures and to ease the burden of taxes during periods of depression. The surplus funds would be used to retire debt at an accelerated rate as well as to set up reserves. In the current situation, as in prosperity periods generally, the retirement of debt offers several important advantages:

1. It will give greater flexibility to postwar budgets. The preferential claims of interest charges and repayment constitute an overhead cost in state and local budgets which, if large, impose a serious element of rigidity and may impair the support of basic services in periods of depression.

2. Debt reduction will lower the cost of government to the residents. Unlike the situation for the national government which borrows from its own citizens only, most state and local units must borrow to a large extent from individuals and institutions located in other jurisdictions, so that the payment of interest involves a real cost to the members of a debtor state or locality.

3. Debt reduction will enhance the credit standing of the state or local government and thus better enable it to maintain its expenditures in depression when net additions to the income flow are crucial.

For similar reasons, the creation of a capital reserve fund is desirable. Part of the current budgetary surpluses would be set aside to ease the financing of capital outlays in periods of depression. Another plan, suggested by William Stanley Parker, is that of establishing a general reserve fund which would be available for all budgetary requirements in depression rather than limited to capital outlays. According to the Parker plan, such a reserve at the local level would be created by annual deposits, out of taxes, of 2 per cent of the authorized budget. Withdrawals from the fund would be on the basis

of a formula aimed at determining the community's current ability to finance its normal activities. The formula suggested is based on three indices—assessed values, per cent of taxes collected, and welfare expenditures.

In line with the concept of counter-cycle budgeting, in periods of prosperity the issuance of refunding bonds should be avoided, and all or a considerable part of current capital outlays should be financed from current revenues. The feasibility of a policy of current financing of capital outlays will depend, of course, on the size of the city.

Tax Structures

The crucial factor in a counter-cycle program of financing is the character of the tax structure. The budgeting of surpluses in periods of prosperity is extremely difficult unless the state or locality can profit from the increasing volume of business and the increasing payrolls. It is noteworthy that whereas total state tax collections increased 12.8 per cent from fiscal 1941 to fiscal 1942, state corporation net income taxes increased 51.4 per cent during the same period. But even with this increase, such taxes made up only 5.6 per cent of total state tax collections in fiscal 1942. It should be noted also that general sales taxes increased 14.7 per cent, or just about at the same rate as the total tax increase. The revenue producing power of the individual income tax is similarly striking. Federal receipts from the individual income tax for fiscal 1942 were $3,108,000,000. These receipts were on the basis of the Revenue Acts of 1940 and 1941 with their relatively liberal exemptions and rates. The Treasury has estimated that receipts from the individual in-

come tax in fiscal 1943 would be $4,800,000,000 if the rates of the 1941 Revenue Act were maintained. This figure is indeed impressive, being larger than total federal tax collections throughout most of the thirties.

There is no escaping the fact that if increased national income in periods of prosperity is not adequately reflected in state and local tax collections, they can do relatively little to prepare to combat depression. The result is that a vicious cycle is generated. If states and localities enter a depression period with insignificant surpluses and with heavy debt, their credit capacity is limited and they are forced to rely on cyclically insensitive taxes, chiefly transaction taxes. Thus, they not only are unable to maintain their outlays and thereby provide employment and purchasing power, but they are forced to impose taxes which bear heavily on consumption and which, in the case of the property taxes, tend to discourage private construction.

This vicious cycle can be broken by a greater reliance on taxes which respond to a business upturn, so that substantial budgetary surpluses become possible in prosperity—surpluses which can be used to maintain service expenditures and capital outlays in periods of depression.

At the local level, several improvements are called for:

1. Assessment procedures need to be improved to permit prompt reassessment of properties favorably affected by business expansion.

2. Most of the property exemptions now existing should be wiped out, and an improved and more standardized arrangement of in-lieu payments for land and properties taken over by the federal government should be made.

3. Back taxes should be collected at once. If the accumulation of unpaid real estate taxes are not wiped out at the present time, they certainly will not be collected later.

The problems involved in financial preparation for postwar public works are clearly part and parcel of the larger problem of adjusting state and local fiscal structures to an economy of ebb and flow. An analysis of this problem highlights the need for certain improvements in financial mechanisms and tax structures. These improvements may permit us to take much of the "leanness" out of lean years.

PART FIVE

STATE AND LOCAL FISCAL RESPONSIBILITIES IN WINNING THE WAR

This session consisted of an address by Mayor F. H. LaGuardia followed by five-minute talks by several other speakers.

CHAPTER XII

POSTWAR FISCAL PLANNING IN NEW YORK CITY

FIORELLO H. LA GUARDIA

Mayor of New York City

EDITOR'S NOTE: Mayor La Guardia spoke extemporaneously and there was unfortunately no stenographic transcript of his address. Because of the stimulating character of his remarks, however, we are reproducing this press account of his address as recorded in The New York Times, November 29, 1942:

A CLEAR division of the sources of revenue among the Federal, State and local governments was advocated yesterday by Mayor La Guardia as a necessary step to avoid wholesale bankruptcy of cities in the post-war period.

The Mayor told the Tax Institute Symposium held by the Wharton School of Finance and Commerce of the University of Pennsylvania, that careful planning would be necessary if every important city of the country were not to face bankruptcy within thirty-six months of the end of the war.

He disclosed to the members of the symposium, in session in the Hotel Pennsylvania, that he was leaving to his successor plans for a program of post-war construction of upward of $800,000,000. He also explained that he would need $30,000,000 for the development of these plans.

"I don't envy the next Mayor," said Mr. La Guardia. "I took the city over in a bankrupt condition and for

three years I went through hell. I don't want to wish that onto any one."

The Mayor held that the vast construction program that he has in mind to forestall unemployment with the demobilization of fighting forces and workers in war industries is part of an undertaking as necessary as winning the war.

"The war doesn't frighten me any longer," he said. "We are set for it. But what would happen in this country unless we have a definite program [of reconstruction] is frightening. All our plants are geared to war production. It will take a year and a half to transfer industry back to peacetime basis. You're going to have a staggering national debt that the human mind cannot comprehend."

Mayor La Guardia confessed impatience with those who ignore post-war difficulties. He said he had discussed the outlook with some of the most important bankers of the city and that the usual reply was: "Let's win the war first."

"We can't leave it that way," the Mayor insisted. "These problems must be attacked from every different angle. I believe we will have to have a public works program ready to go, so that at once we can start construction of gigantic size. I will leave to my successor a complete engineering program with working plans of public improvements ready for construction, if money is available at the time."

Mayor La Guardia made it clear that the city should undertake such a program with the aid of the Federal and State Governments.

Advocating a revamping of the whole taxation system, the Mayor suggested that the Federal Government should

preempt entirely the income and corporate tax field, with a percentage of restitution for the States. He further would leave the field of excise taxes to the Federal Government, which he said should allow a percentage of restitution to municipal and county governments. The Mayor pointed out that the municipalities still relied largely on real estate taxes.

CHAPTER XIII

FISCAL RESPONSIBILITIES OF STATE GOVERNMENTS IN WINNING THE WAR

ALVIN A. BURGER

Director of Research, New Jersey State Chamber of Commerce

LET ME first dwell briefly upon one fiscal responsibility which I strongly believe does not devolve upon state or local governments in connection with the war effort. I refer to the responsibility for levying so-called "anti-inflation" taxes.

Some persons in high places have been urging that our states and municipalities maintain high tax rate schedules as a curb on inflation, and have suggested that surpluses arising from such taxation be used to build up reserves to finance postwar improvements. I cannot agree with this position.

In the first place, any part which states and municipalities might attempt to play in curbing inflation through taxation obviously would be inconsequential. Second, taxes thus levied in excess of current state and local budgetary needs would in many cases fall upon the victims of, rather than the contributors to, inflation. The bulk of property taxes, for instance, are paid by salary-earning home owners, by industries which are even now operating on their inventories in order to meet federal tax burdens, and by owners of apartment and business buildings whose income is restricted by rent ceilings. They are the sufferers from any inflationary condition

which may exist. Inflation is being created by the vastly increased spending power of millions of war workers who, for the most part, do not own property. The federal government alone can tax this spending power to the extent required.

Third, the question of entrusting postwar reserve funds to state legislatures and to local governing bodies is debatable. The taxpayer has no assurance in most cases that such reserves will ultimately be used for the purposes for which they were originally set aside.

It is much more sensible to urge that our state, municipal, and county governments take advantage of the war situation to curb spending, reduce bonded debt, eliminate floating debt, establish cash basis or "pay-as-you-go" budgeting, and otherwise put their financial houses in order so that they may be fully prepared to meet whatever conditions the war's end may bring.

War-Induced Fiscal Trends

There are certain fiscal responsibilities which the states even now are fulfilling almost automatically as a result of war conditions.

Operating expenditures are being held in check because state governments, faced with loss of personnel to the armed services and to industry, are finding it difficult to fill vacancies thus created, and because many kinds of equipment and materials cannot now be purchased. The shortage of autos, tires, and gasoline, for instance, has necessitated extensive car pooling.

Debt is being reduced because the nation-wide taboo on capital improvements precludes any new borrowing.

Full right-of-way, therefore, is being given to the federal government in its appropriation of available manpower, materials, and borrowing and taxpaying resources heretofore utilized by the states, all in the common interest of winning the war.

Improvements Made Opportune by the War

There are other fiscal responsibilities, however, which cannot be fulfilled except upon the initiative of the states themselves. The war situation affords the states an unusual opportunity to undertake a program of house cleaning on a grand scale.

Now is the time to subject to critical analysis the whole structure of state services and functions, and to eliminate overlapping and nonessential activities and personnel. The real benefit to be derived from such efforts will be measured not so much in terms of tax dollars saved as in terms of an organization more adequately equipped to meet the stress and strains of both wartime and postwar demands, whatever they may be.

Now is the time to overhaul civil service systems, to afford postwar assurance of a better handling of personnel selection, retention, and promotion on a merit basis. One day the war will end, and our state governments should be prepared to take steps to recruit for their uses the cream of the manpower released by our armed forces, rather than just sit back and take the skim milk that is left to be foisted upon their departments by political pressure groups.

Now is the time for those states which have not already done so, to get out their blueprints for modernizing their budgeting, accounting, and reporting systems, and pro-

ceed with the installation of such plans. In the last world war a great deal was done along this line, and again during the recent depression. It seems that great national crises provide the best opportunities for the taking of such forward steps.

Now is the time for state legislatures to draft and enact sound legislation providing for sensible, effective state supervision of municipal borrowing and financing, budgeting, accounting, and tax collection. New Jersey wisely enacted such legislation several years ago, under pressure of a thoroughly aroused and well organized taxpaying citizenry, and these laws have already begun to pay rich dividends in the form of substantial debt and property tax reduction and greatly improved municipal finances.

Responsibility Rests with the People

In the last analysis, of course, the real responsibility for putting state governments in proper readiness to meet whatever fiscal demands the war or postwar period may impose upon them, rests with the people themselves. Improvements will not be made if there is no general and active public support for them.

It is said by some that the American people are too intent on winning the war to bother with any of the ordinary problems of government. I do not believe this to be true. Witness the interest in more than a score of states in constitutional revision. Witness also the nationwide concern with federal inefficiency and waste of manpower and money. The people are too well aware that we are in a war to save the democratic processes of government, and that this war can be won in the long run

only if it can be demonstrated that democratic government can meet every emergency and respond effectively to every extraordinary demand.

War to End Dictatorships at Home

And while we are at war against foreign dictatorships, it is important that we wage a relentless war at home to exterminate the costly little dictatorships that feed upon the substance of many of our cities and even some of our states—the Hague and the Kelly-Nash machines and others like them, large and small.

Some may think that such a suggestion has little to do with a discussion of fiscal responsibilities of state and local governments—but it has. Speaking for New Jersey, I can say that we have a great deal of good government in our state, and the great majority of our municipalities are very well governed and well financed. But the country at large doesn't know about that. The bad advertising given our state by the Hague machine has cost our taxpayers large sums as a result of the unfavorable market accorded New Jersey municipal bonds from time to time. The Hague machine has been an expensive luxury to New Jersey taxpayers.

To sum up, it would seem that it is the primary responsibility of our people in this crucial hour to make our democratic processes work so efficiently that there can be no excuse, in times to come, for the existence of any dictatorships, large or small, either at home or abroad.

CHAPTER XIV

STATE FISCAL RESPONSIBILITIES IN WARTIME

CHESTER B. POND

Director, Research and Statistics Bureau, New York State Department of Taxation and Finance

THE STATES have received abundant advice from all sides as to the proper conduct of their fiscal affairs during the war emergency. While there is great diversity in the scope of this advice, it seems to be the consensus that state fiscal policies should accomplish the following broad objectives:

1. Harmonize with wartime federal fiscal policy in such matters as controlling inflation and spreading equitably the greatly increased tax burden.
2. Reduce expenditures to the very minimum consistent with efficient performance of necessary services.
3. Maintain tax structures at or about the present level, in order to
   a. Reduce outstanding debt.
   b. Accumulate a surplus for the uncertainties of postwar conditions.

There can be little disagreement with any of the objectives outlined above, with the possible exception of that which calls for the creation of a surplus. Even here, the disagreement is one of degree rather than of kind, since the amount of the surplus to be created is the all-important factor. The controversy between those who favor the interest of the taxpayer and those who are seeking to protect the financial soundness of the state will

result in a balance between the contending forces which may be expected to vary from state to state.

These objectives have been dwelt upon at great length and thoroughly discussed in this symposium and in numerous forums where problems of state public finance receive the attention of experts in the field. The discussions have reached the point where little, if anything, can be added. In the final decision concerning the desired objective, much depends upon the background and attitude of the individual, and the stage of conviction, once reached, is not easily disturbed.

Under these circumstances, it seems more fitting, therefore, to direct attention to a much neglected phase of state public finance, but one which in the not too distant future may demand a solution. The depression years have left an indelible mark upon the economic life of the nation, a mark which has extended into and greatly influenced the state tax structures. Especially is this true in New York, where a series of stop-gap measures was enacted to bolster dwindling revenues at a time when state expenditures were rising. As a result, the state of New York finds itself, in an era of war, supported by a tax system carried over from a depression economy. It is true that the rise in tax yields made possible the elimination of the 1 per cent emergency tax on personal income and even extended to the point where the normal tax was cut 25 per cent for the years 1942 and 1943, but the majority of the emergency levies which were imposed in the form of added tax rates or new taxes, remain with us.

The period through which we are passing will place the greatest burden on the American taxpayer that he has ever known. Nor is it likely that this burden will decrease markedly within the lifetime of this generation.

It is the duty of government at all levels—federal, state, and local—to promote equity and to seek sound integration of the entire tax burden, for it is this entire burden which is significant. The states can make their greatest contribution by placing their tax houses in order at a time when restraints on change are far less potent than normally. They can thus do much to obviate any later criticism which may be leveled against them for failing to take cognizance of tax realities. Thus, the states' contribution can be made part of a broad program of tax reorganization, necessitated by the demands of the tax burden and the awakening of the citizen to the problems of overlapping taxation. If the states play their part faithfully and well by pioneering in tax modernization, the integrity and sovereignty of the American state will be able better to withstand the pressures of excessive bureaucratic centralization which totalitarian war and its consequences inevitably bring.

CHAPTER XV

MEETING FISCAL RESPONSIBILITIES THROUGH GOVERNMENTAL REFORM

Robert S. Ford

Director, Bureau of Government, University of Michigan

One of the chief responsibilities of cities during the war is to develop more effective planning. This should not be planning for the sake of planning but for the purpose of improving administrative relationships between the various levels of governments. The need of coordinated planning is well illustrated in a number of metropolitan communities throughout the country where there has been all-out conversion to war production as well as a large increase in population.

The problem of the metropolitan community has existed for many years. It has become more serious during the war because of the establishment of large war plants in unincorporated communities within such areas. Almost one-half of the American people live in the 140 metropolitan areas around cities of 50,000 population or more. In the past decade the central city in 34 of these areas declined in population, while the population in adjacent areas increased. These adjacent areas make it necessary for cities to incur larger expenditures for streets, police and fire protection, etc. The problem of the metropolitan community is one of the most challenging in the field of government at the present time, and this will undoubtedly be true after the war. We need to

re-examine functional and revenue relationships between the city, county, state, and federal governments.

Local government needs to put its house in order during the war by reorganizing and modernizing its structure. There are about 175,000 units of local government in the United States, and 127,000 of these are school districts. Many illustrations could be cited as to the need of reorganization, but perhaps the most glaring is the case of school districts. This problem is being recognized in Michigan, and there are many who feel that some substantial reduction in the 6,600 school districts of that state can be accomplished during the war. A definite plan has been formulated there for reducing the number to about 500. Whether the plan will be adopted or not remains to be seen.

One of our main objectives during the war should be the preservation of local government in the face of the strong trend toward federal centralization. If local government is to be preserved and strengthened, however, it must be a modern and efficient form of government and not one that creaks along within the old framework of outmoded, useless, and expensive units.

CHAPTER XVI

FISCAL RESPONSIBILITIES OF SMALLER MUNICIPALITIES

ARNOLD FRYE

New York City

MAYOR LA GUARDIA has spoken eloquently of the war and of the responsibilities of municipal officers in time of war. He has emphasized the advisability of the planning of public works as a precaution against a period of prolonged unemployment, stating that he is having prepared the definite plans and detailed blueprints of a great number of desirable projects, in line with the policy which, in the early years of the depression, he followed with such conspicuous success.

Mr. Cunningham, the able deputy comptroller of this great city, has pointed to other fiscal problems. Dr. Bird has urged the importance of sound fiscal practices, a need which was brought home to us during the depression and which is even more evident in time of war. The other speakers have touched on nearly all other phases of state and local government.

No one, however, has said much about the smaller municipalities, particularly those which have not been directly affected by the war. In spite of a long professional association with the finances of states and large municipalities, including some association with and intimate study of the finances of New York City, I have always lived in the suburban municipalities and have had

close personal contacts with the officers and the problems of these municipalities.

When I refer to municipalities which have been less affected by the war, I mean the municipalities which have not felt the up-surge of war production. I do not mean that the residents are not interested in the war. On the contrary, more than a quarter of us who constitute the adult population of such municipalities, being unused to having the executives of great city governments to look after us, have joined the civilian defense services, taken first-aid courses, and patrolled the streets as air-raid wardens or auxiliary policemen. Our wives and children have been so active in the Red Cross and in rationing, salvage, consumer education, and similar activities that we seldom see them.

We take our municipal problems very seriously. We have suspended all public improvements, we have greatly reduced maintenance costs, and when our municipal employees go into the armed services, we leave the vacancies unfilled. Unrepaired pavements reduce traffic and smaller police forces are supplemented by our volunteer auxiliary policemen. Operating costs are being constantly reduced, although we are obliged and desire to increase the salaries of municipal employees in the lower brackets because here inequalities and inadequate compensation become more burdensome in a period of increased living costs.

Although many of the suburban municipalities found themselves at the beginning of the depression with both permanent and short-term debts that were excessive in a period of reduced tax collections, and have, in consequence, largely eliminated their floating debts and greatly reduced their outstanding bonded indebtedness, they are

now vigorously endeavoring to continue the reduction of debt and are actively engaged in planning postwar improvements, even though they may not be as efficient as New York City in developing these plans to the blueprint stage. We hope that they will follow the good example of Mayor La Guardia in being really prepared for a postwar period of unemployment.

We now come to the real problem which these municipalities face. It is this. Their residents are not receiving the high wages or profits of wartime production and are subject to the heavy burdens of wartime taxation. Many of these municipalities are faced with further reductions in assessed values of residential property and may have difficulties in collecting the real estate taxes which constitute the greater part of municipal revenues.

Federal commissions have been urging the maintenance at the present level of state and municipal taxation and the creation of cash reserves for use in the postwar period. Many of the municipalities to which I refer, have no such question. Instead of maintaining their tax levies, they have started to reduce them and may well have difficulties in collecting the reduced amount of such taxes as they are able to levy. This brings us to the question of refunding, i.e., the extension of the time of payment. We do not like such extensions, and I personally agree that refunding is unsound. I hope that much of it can be avoided, but I am being forced to recognize that substantial fiscal adjustments may be necessary in those municipalities whose residents are not receiving increased incomes, and are subject to both an increased cost of living and heavy federal taxation.

I have said today after listening to the other speakers, particularly Mayor La Guardia, I would discuss the small

municipalities which are not profiting from wartime production. The reason is that consideration of their fiscal problems emphasizes the principal point made by Mr. La Guardia, namely, that the experience of the depression and of this wartime period proves that municipal finances should not be as dependent as they are upon real property taxes. Real property is overtaxed. Let us hope that as a result of this war, and as soon as possible after the war is over, there will be a revision of our entire tax system, federal, state and local.

Notwithstanding financial difficulties which these municipalities may encounter, I can assure you that they are doing and will continue to do all in their power to aid the nation in which they so strongly believe.

CHAPTER XVII

WARTIME FISCAL RESPONSIBILITIES OF MUNICIPALITIES

FREDERICK L. BIRD

Director of Municipal Research, Dun & Bradstreet, Inc.

THE WARTIME responsibilities of our municipalities are dictated both by the necessities of the present and the uncertainties of the future.

This means that financial policies and financial plans must contribute not only to the effective conduct of the war, but must look well ahead to the maintenance of financial stability in the postwar period of adjustment. For a military victory in the field would be a rather futile victory if it were accompanied by the loss of our system of local self-government.

This conference on the wartime problems of state and local governments has produced, in all of its sessions, discussions of responsibilities as well—and there have been some sharp differences of opinion. For example:

Should state and local governments raise taxes to aid in closing the inflationary gap or should they lower them to relieve the taxpayer?

Should they build up cash reserves for postwar exigencies?

Should they accumulate large funds to finance postwar capital improvements?

It seems to me, without going into the merits of these more or less theoretical proposals, that there are four

basic, practical responsibilities that municipalities can agree on and work on—must work on, in fact.

First: Municipalities are the congested, complicated centers of war goods production and transportation. They cannot afford to break down. Every effort needs to be made to maintain health, safety, and efficiency of movement. This is what should dictate the making of budgets and raising of revenues, rather than tax reduction as a primary objective. If under the pressure of necessity, however, new ways of economizing can be discovered, we shall have made a long-term gain.

Second: There may be some question about building up postwar reserves, but there should be none about the responsibility for getting rid of existing deficits and avoiding the incurrence of new deficits. This means, among other things, abandonment of long-term borrowing for unemployment relief which still persists in a few areas.

Third: There may be considerable doubt as to the advisability of accumulating large funds for postwar construction. There should be none about the responsibility for meeting debt obligations from current revenues when they fall due. A number of cities are considering postponement of their obligations by refunding. If they do this they not only violate sound principles of debt administration, but by failing to take this opportunity to reduce their debts they are missing an excellent opportunity to build up postwar reserves—by cutting down fixed charges in future budgets and by building up reserve borrowing power.

Fourth: The problems of wartime are disclosing or emphasizing weaknesses in budget and bond laws, in methods of fiscal administration, and in the operation of

revenue systems. They are showing that some state regulatory legislation is a handicap to cities and that many states have been negligent in their responsibilities to their municipalities. There could be no better time for the correction of these defects than the present, when the defects are so evident and the feeling of responsibility is strong.

If we take care of these fundamentals now we contribute not only to winning the war but to solving the problems which will come later.

APPENDIX

REPORTS OF REGIONAL ROUND TABLES ON STATE AND LOCAL WARTIME FISCAL PROBLEMS

APPENDIX

REPORTS OF REGIONAL ROUND TABLES ON STATE AND LOCAL WARTIME FISCAL PROBLEMS

It is with considerable pride that the Tax Institute presents the following reports. Early in the summer the Administrative Board of the Institute began to consider the possibility of holding various regional meetings throughout the country as a means of acquiring firsthand information concerning the problems created by the impact of the war on state and local finances, and as a preliminary to the national symposium on the same topic scheduled to be held in New York on November 27-28. It soon became clear that a quite different type of meeting from the usual speechmaking affair was called for, and it was decided to try to arrange something in the nature of round tables in eight or ten different parts of the country. Further details concerning the meetings as well as the working out of topics for discussion were left to the committee which had already been set up for arranging the program for the symposium.

Explanation of Pattern of Round Tables

The program committee worked out a basic pattern to be followed. The essential features were stated as follows:

The underlying objective of the round tables is to find out what are the wartime fiscal problems of the various regions and how they can be

met, keeping in mind the fundamental interest of the citizen in the proper functioning of all three levels of government. These round tables are not intended to consist of prepared addresses but of panel discussion on the part of specially invited participants. The discussion will follow an outline of topics to be prepared by the symposium program committee.

Each round table will be organized by some competent person within the region who will take full responsibility for the conduct of the round table and who will also act as chairman. There will be a reporter who will prepare a digest of the views in his region, as presented at the round table. The chairman and reporter are to be appointed by the program committee of the Tax Institute. The selection of round table participants will be made by the chairman and reporter. Participants should consist of state and local government officials, business men, bankers, and representatives of civic groups, such as bureaus of municipal research, civic leagues, leagues of women voters, city clubs, chambers of commerce, taxpayers associations, etc.

The region represented in the round table should not be limited to one city. Nearby cities of the same state and as many adjacent states and cities as practicable should be included. It may be desirable, however, to limit the number of participants to fifty so that there may be opportunity for a real exchange of ideas.

It seems desirable to hold at least two sessions (probably morning and afternoon) so that consideration may be given to the various problems outlined. More sessions may be held at the discretion of the chairman.

The topics to be discussed will be outlined by the symposium program committee in order to insure some uniformity of general approach. Sufficient mimeographed copies will be made available so that one may be sent to each participant in advance of the meeting. It should be emphasized that participants are not expected to make a speech but to participate in a discussion. It is hoped that out of this meeting of minds there may emerge a clear statement of the fiscal problems of the community which have been engendered or intensified by the war.

It is further hoped that by piecing together these regional reports, there may result a summary statement of the wartime problems of state and local finance for the country as a whole. These regional summaries will provide symposium speakers with basic field material for use in the preparation of their papers.

The program committee prepared for discussion at these round tables a three-page list of questions on state and local fiscal problems created by the war and methods of meeting these problems.

In deciding on the location of the meetings the first effort was to name regions that would represent geographical diversity and to some extent different types of war impact. Cities which were key centers of these regions were selected for the holding of the meetings.

Since the organization and conduct of these meetings was to be carried out entirely by local leadership, selection of personnel was of prime importance. The Tax Institute is a nation-wide organization and has members and friends in all sections of the country and therefore it had the valuable contacts without which such a network of meetings would have been impossible. Careful selections of personnel were made. From that point on the local organizers took hold, made arrangements for the round table, selected and invited participants, conducted the meeting, and prepared a digest of the discussion.

From information obtained concerning these round tables through correspondence, through the prepared digests, and through the personal attendance of the director at two of them (Boston and Detroit), it appears that a distinctive and highly valuable pattern of meeting has evolved.

It is believed that the Tax Institute has developed a method of procedure which has great possibilities as a means of ascertaining the informed opinion of the country on a particular set of problems. One of the pleasant features about the meetings which have been held is that everyone seemed to enjoy them tremendously.

Four round tables were conducted—in Seattle, Detroit, Denver, and Boston. Digests of the discussions are contained in this bulletin. A round table had been planned for Florida. Because of transportation difficulties the

meeting was cancelled, but a memorandum has been received from that state which is also included.

SUMMARY OF REPORTS

The topics outlined by the symposium program committee for discussion at the regional round tables were grouped under four main headings: effect of war on problems of intergovernmental exemptions, problems involved in wartime extension of governmental services, changes in local revenues brought about by war, and appropriate wartime fiscal policy for state and local governments.

Effect of War on Problems of Intergovernmental Exemptions

These problems fall into three main groups:

1. Exemptions from state and local property taxes of federal property, privately operated industrial property built with government money, and foreign property used for war-production purposes
   a. Service payments on exempt property in lieu of taxes
   b. Relation of exemptions to assessments
2. Exemptions from state and local sales taxes in case of cost-plus contracts
3. Exemption from federal income tax of interest from state and local securities

Tax Exemptions and In-Lieu Payments

Judging from the round table discussions, there appears to be considerable dissatisfaction with the system of in-lieu payments as developed and administered during the last few years.

The findings of the Seattle round table were expressed in the form of recommendations representing a consensus

on the part of participants. The group took the stand that it be adopted as a principle that payments in lieu of taxes be made by the government agencies to the same extent that payments are made by like properties.

A suggestion made at the Detroit meeting in connection with the problem of federally owned real property was that such property be subject to taxation in the same manner as privately owned real estate. "The suggestion which received most consideration was that the payments made by the federal government in lieu of local taxation should cover the full costs of the services rendered, such as for fire and police protection, sewage, etc." The point was made that when mammoth plants are suddenly built up in what had formerly been a cornfield, a policy of in-lieu payments based on taxes previously collected in the area has little significance.

It was further pointed out that when large war plants are established it can hardly be expected that the local units of government alone would be able to bear the brunt of the increased costs—particularly when it is quite likely that many of these plants will not continue in operation after the war. In some instances, the establishment of certain plants has virtually created a new urban community in a rural township that is utterly incapable of dealing with the situation. It was suggested that federal grants will undoubtedly be necessary for schools, housing, etc.

Considerable financial difficulty has been caused to local units in Michigan by widespread exemptions resulting from conversion of plants to war production.

If a company is working on a lump-sum contract, the machinery and inventory are taxable; but on a cost-plus contract, title to the material passes to the federal government and it cannot be taxed as personal property. An additional problem arises, as in Detroit, when a large

plant is owned by a foreign government and is entirely exempt from taxation under international law.

The Denver round table recommended that the "federal government should provide adequate compensation in lieu of taxes or services when properties acquired by the federal government, for any purpose whatsoever, are taken off the local tax roll." It further recommended that an attempt be made to "increase in-lieu payments to make them comparable to loss in ad valorem taxes."

It was agreed that payments now received in lieu of taxes were hardly more than token payments, although provision has now been made for the payment of full taxes which would be assessed against private building. Appraisal is made by a federal tax analyst. The valuation is usually conservative and the local mill levy is applied to the previously determined base.

Military zones and camps located in rural areas of counties appear to have reduced the amount of taxable property often creating serious situations. A particularly different problem is involved in the influx of workers living in trailers and shacks who pay little or no taxes but require municipal services. The school problem becomes especially serious. Military authorities make demands on county authorities for continuous maintenance of roads in all weather. Few rural counties have sufficient revenue to provide such services. Direct aid through federal grants is necessary in many cases to assist in highways, schools, health, and sanitation problems.

The exemption of federally subsidized housing projects came in for special consideration at the Boston meeting. "Although there were minor differences of opinion, there was practically unanimous dissatisfaction with the existing situation."

The discussion showed that

wartime tax exemption problems will not be solved by the coming of peace. States and localities were dissatisfied before the war with the size of payments in lieu of taxes on federal housing projects. The real estate taxpayer has felt himself unduly burdened by the method of subsidy through tax exemption. The effect of additional exemptions of city real

estate on city land values and on the relations between urban and suburban land values is causing alarm in many quarters.

The complete exemption from local taxes of property which is both owned and operated by the federal government seemed to be generally accepted and taken for granted. It was mentioned with approval that the federal government had contributed to school costs in towns adjoining certain army camps but it was not suggested that these contributions bore any relation to the values of exempted property. The attitude was quite different in respect to privately operated industrial property on government land.

The effect of a large industrial plant on a residential community was well illustrated by the situation in Hingham, Massachusetts. The federal government has taken over a shipyard which is being operated by the Bethlehem Steel Company. The shipyard is expected to employ about 20,000 workers. The town has been unable to collect any money from either the federal government or the Bethlehem Steel Company. At the same time the town finances have been adversely affected in at least three ways—great increases in the wear and tear on the highways with resulting greater cost of upkeep and repairs, greater demands on the police force in enforcing traffic and parking regulations, and a loss of employees to the shipyard because of higher wages. A similar situation was cited in Brunswick, Maine. Apparently local authorities believe that the localities should be reimbursed for at least the extra costs caused by such projects.

The problem of tax exemptions and in-lieu payments was not discussed in the Florida memorandum.

No light was shed at any of the round tables as to whether the rapidly increasing amount of exempt property was forcing up assessments on taxable property. It may be too early for any trend in this direction to become apparent.

Exemptions from State and Local Sales Taxes

This topic generated little interest at the meetings and no conclusions on the subject were reached. This lack of attention may have been due in large part to the crowded program which contained a number of more engrossing topics.

It was stated in the Denver report that

> There is an imperative need for clarification on tax exemptions for war contracts, particularly in the building industry. There are some 25,000 tax collectors in Colorado collecting sales, service, and use taxes. There is not only a need of clarification of tax exemption laws but there is also badly needed an educational program for collectors and in the schools.

Exemption of State and Local Bond Interest

The Seattle round table recommended that "the income of future issues of state and local securities be subject to state and federal taxation."

The Detroit and Denver round tables did not consider this problem.

At the Boston meeting, there "was considerable division between academic opinion and the opinion of the officials of state and local governments."

> The expressed academic opinion was in favor of eliminating the exemptions as a step toward better application of progressive income tax rates. The other group felt that if the exemptions were removed, it would increase the power of the federal government over state fiscal affairs and increase the costs of state and local borrowing. A variety of figures were quoted on the possible addition to interest payments which would be required of states and localities if the exemptions were removed. Some persons felt that such increase in rates would discourage borrowing and that that would be undesirable. Others felt that it would be desirable to discourage borrowing. Still others felt that the rate of interest had little effect on the amount of state and local borrowing.

General Comments on Tax Exemptions

Generally speaking tax exemptions were viewed with disfavor at the meetings. The Seattle round table felt "that the question of removing and eliminating intergovernmental exemptions should be explored with a view

to minimizing them as far as possible." It also recommended that "the Tax Commission of the state of Washington be invited to furnish a survey statement on the extent of intergovernmental exemptions in the state of Washington."

The Denver round table stated that "the reduction and elimination of tax exemptions would increase the revenue of governmental units." The definite recommendation of "no encouragement, and if possible, elimination of exemptions" was made.

It was noted at the Boston meeting that many exemption problems would be less serious if it were not for the burden upon real estate.

The real estate aspect of the difficulties might be lessened if more local functions were taken over by the states, if the localities were to adopt a city income tax such as that of Philadelphia, or by increased use of sales taxes. One speaker felt that intergovernmental exemptions are becoming so increasingly complex that the best solution would be the complete elimination of such exemptions by some sort of mutual agreement.

Problems Involved in Wartime Extension of Governmental Services

At the Detroit meeting, the Acting State Budget Director mentioned increasing expenditures for payroll, public welfare, and defense activities. The general effect was mixed—both decreases and increases being realized or anticipated in state and city expenditures.

The most acute phase of the problem is in connection with the location of large war plants, particularly in rural areas. The sudden influx of a large population in a sparsely settled area and the furnishing of urban services to these settlements has posed a difficult problem in many communities.

At the Denver meeting, Colorado Springs was used as an illustration of various points brought up in the discussion.

A 14 per cent increase in civilian population necessitated increases in the police force and budget despite numerous military police provided by the camps. Health department and sewage disposal plant facilities are taxed. School population has increased to capacity in the lower grades. The city has found it necessary and desirable to undertake and finance a recreation program for service men. New gas, water, and electricity services to military establishments have been satisfactorily handled with the army paying in full for services rendered. Serious shortages in taxes are added to a difficult transportation system. Housing is not yet inadequate. Problems of juvenile delinquency are serious.

It was stated officially at the Boston meeting that

In general there have not been large war-created expenditures in New England. Priorities have prevented the purchase of new materials and, thus, stopped new public building, public works, and even the renewing of equipment for fire departments. In some instances there have been increases in expenditure on purification or protection of water supply systems. Governments may have to step in to relieve the transportation situation in some localities. So far, most communities have been able to meet the few new war expenditures by transfers from reserves.

Some cases were cited where the building of new war plants or bases were creating problems which local governments could not solve. Special mention was made of a new war plant in East Longmeadow, Massachusetts, and of the region near the Quonset Point base in Rhode Island. It was noted that large communities are able to absorb the shocks created by extensive new developments but that small and medium sized communities may be swamped by them. This type of situation appears to be less serious in New England than in some other parts of the country.

It was pointed out in the Florida memorandum that

Municipalities are also confronted with the immediate need for expansion of nearly all facilities for the servicing of abnormal gains in population as a result of military establishments. Of increasing importance is the problem of finding new sources of revenue for municipalities.

Revenue Changes Brought About by the War

At the Detroit meeting, it was reported by a state revenue official that sales tax collections had shown an increase in every county in the state in the six months from February to August, 1942.

> A significant change has occurred in the source of sales tax collections, with the relative importance of the tax on food sales having risen from 25 per cent of total sales tax revenue to 39 per cent of the total. The explanation for this may lie in the increased cost of food and also in the increased buying of food.
>
> . . . gasoline tax collections here may not decline as much as in some states not having so many war plants. The decline in gasoline and automobile registration taxes in the next calendar year will not affect general activities of the state, because the proceeds of these taxes can be used only for highway construction and maintenance by constitutional provision.

It is expected that liquor sales will be smaller, but that this drop will probably be offset by increased prices. The yield of the local property tax has not yet been affected, but property tax delinquency is expected to become a problem later.

At the Denver meeting it "was admitted that it is difficult safely to assert whether or not losses will exceed gains. Certain communities are losing income and others are gaining, due to the war effort."

According to opinions expressed at the Boston meeting "the war seems to have brought to New England few changes in local revenues. Additions to local revenues by federal aids have not involved fundamental changes in local revenue systems."

The Florida memorandum points out that gasoline tax collections have fallen off and are expected to decline further. Racing receipts are expected to decline. Auto

license receipts were higher in 1942 than in 1941 due to increased rates, but are expected to be off 30 per cent next year.

Other revenues are, or will be, greatly decreased and it is evident that the state must find other sources of revenue or be forced to curtail its state aid functions. Municipalities have special problems. They receive no state financial aid and have been seriously affected by the homestead exemption law and other laws reducing property tax income.

Appropriate Wartime Fiscal Policy for State and Local Governments

This was by all odds the most engrossing part of the discussion in each of the round tables. Policies with respect to improvement of administration, governmental economy, tax reduction, disposition of surpluses, and public works reserves came up for discussion.

Administrative Improvements and Governmental Economy

The Seattle round table held that "the campaign for governmental economy is more applicable to the federal government than it is to the state governments. Essential state and local government functions should be maintained, but certain government functions, as public works, should be curtailed to the very minimum."

The Denver round table took the stand that this "is the time for a close scrutiny of activities of local, county, and state governments; that since it will be necessary to cut staffs to the minimum an appraisal of organization and management on the basis of efficiency of operation is in order."

The following ten proposals as to how municipalities might keep budgets down at this period was given, although it was made clear that all

of the items on the list were not necessarily recommended: elimination of WPA projects, putting the money aside for future replacement of equipment; refinancing of city bonds at lower rates of interest and the retirement of these bonds; modification or elimination of police car cruising; discontinuance of patrol of residential districts during the day; use of auxiliary police; garbage collection once a week instead of twice; cautious reduction of expenditures on street maintenance; elimination of city advertising; elimination of municipal amusements such as band concerts; and maintenance of the mill levy at the 1942 level.

It was made clear that the principal means of reducing local government costs lies in the postponement of public works and capital outlays until after the war. Priorities on materials and men make such postponement inevitable. It was made clear, however, that this did not mean that because the projects were postponed they should not be planned.

* * * * *

Vacancies being created by men leaving local governmental jobs for the armed forces or war industries tend to counteract increases in salaries, and it was thought that the net result would be a reduction in government cost for personal services. It was agreed that most communities were already working with skeleton staffs and that any further reduction in staff would mean a dangerous reduction in services. It was stated that there are too many "sacred cows" in municipal services and that a careful study might provide sensible reductions in every department.

Tax Reduction versus Accumulation of Surpluses

The Seattle round table recommended:

That state tax rates should be maintained at current levels as a matter of sound public and fiscal policy. The accumulation of surpluses, if they should develop, it was felt, is also consistent with a program of creating reserves for post-war public work and the prevention of inflation, although the latter task is primarily the function of the federal government.

That local governments should maintain their tax rates, even though surpluses arise. It was believed that the accumulation of surpluses probably will be accidental, for millage is levied only for current needs.

That the accumulation of surpluses by state and local governments involves dangers of diversion and of ill-advised expenditure.

That surplus funds of state and local governments should be used: (a) for reducing debts or for providing for the reduction of debts by means of a sinking fund, and (b) for creating special funds for a spe-

cific later use. It was felt that legislative action should provide for the setting aside of these specific reserves. Local officers could be bound by state law to observe such allocations; and, state legislatures undoubtedly would feel duty-bound to respect past action.

Discussion of this problem at the Detroit round table was reported as follows:

Although the state government had a surplus of about $7,000,000 on last June 30, it seemed to be the consensus that state taxes should not be reduced in view of the imminence of sharply declining revenues.

The new federal tax program will undoubtedly result in a reduction in state revenues and in state grants to local units. State aid now constitutes approximately one-half of the state budget. With the decline in sales, gasoline, and automobile registration taxes, local revenues will be seriously affected. There are many local units in Michigan that receive more revenue in the form of state aid than they do from the property tax.

The plan now followed in several other states of investing surplus funds in federal bonds was regarded favorably. It was suggested, however, by State Auditor General Vernon J. Brown that any plan of setting aside or investing surplus funds should also include a provision that such surplus could be spent only on specific appropriation by the legislature.

Local units of government have not experienced any surplus of revenues. With local government debt in the state amounting to about $600,000,000, most localities have had difficulty in meeting debt service requirements. Furthermore, operation of the 15 mill over-all tax rate limitation has created difficult financial problems for many communities since 1933. But even if there were no debt problem, some doubt was expressed as to whether local units could or should be allowed to maintain or invest a surplus created by a tax levy on property. The situation might be different, however, if the funds were used to retire long-term bonds.

The Denver round table recommended that:

At present there should be as little reduction of local taxes as is possible. Wherever feasible and legal, surpluses should be built up. These surpluses could be used where desirable: first, in the retiring of bonded debt; second, as a reserve for emergencies and for planning purposes. . . . State governments should accumulate surpluses whenever possible and an equalization plan should be worked out in order that assistance may be given to those communities in which there has been

a serious income loss due to population change or other factors adversely affecting the economy of a community during the war.

Only two points of view were expressed on the advisability of building up surpluses: first, that local communities will have unexpected war problems to face; and second, local officials may mishandle surpluses. It was suggested that surpluses be built on the state-wide basis since postwar problems will not necessarily be local in scope only. The meeting held no uniform opinion on the future use of local revenues but the meeting seemed to be unanimous that it would be better to accumulate surpluses than reduce taxes. Several interesting points were made on this. It was felt that reduction at this time would make it difficult to raise taxes later when resumption of public works activities would be logical, and it was felt that postwar planning calling for the setting aside of funds now would be advisable. Another means of disposing of surpluses might be in the retirement of bonds, although there was some disagreement as to the advisability of this. It was agreed that there was no standard means of handling the situation and that no two communities would face the same problem.

At the Boston meeting "discussion of appropriate wartime fiscal policies for state and local governments brought out marked differences of opinion."

The only major point on which there seemed to be agreement was that local expenditures would probably be reduced during the war. This reduction is expected because of the almost complete cessation of capital expenditures. It seemed to be generally assumed that in this area increased costs for normal current services and for war-caused services would not be large enough to take up the slack caused by the lack of new building and replacements.

Several possible policies in respect to this war "surplus" were advocated. It was suggested that no tax reductions should be made, that token reductions should be made, that the largest possible reductions should be made. The advocates of no tax reductions felt that debts should be repaid and surpluses built up for meeting postwar needs especially in replacing worn-out equipment and continuing postponed public building projects. The advocates of token reductions had somewhat the same points in mind but wanted to give the taxpayers the present advantage of slightly lower taxes. The third group felt that not a penny should be raised by taxes above what is needed for absolutely necessary current expenses. They believed that the best repository for any backlog for future needs is the pockets of the taxpayers themselves.

Postwar Public Works

The Denver round table agreed that

public works planning at this time was logical and necessary; that local governments should be ready with carefully planned projects in order that it will not be necessary for them to turn to the federal government for aid, and in order that local autonomy be maintained. Any trend to the contrary would be dangerous to our traditional system of government. Plans made now, however, should not be earmarked as flexibility in future programming is essential. Plans should be made in terms of units of materials and man hours rather than costs, since the value of money in the postwar period cannot be accurately predicted. Existing surpluses at that time can be directly applied as far as they will go and form the basis for borrowing power. Since there will be a shortage of skilled labor and highly finished materials, jobs requiring mainly unskilled workers should be scheduled first.

Where state laws or local laws and ordinances prevent the accumulation of surpluses or the earmarking of revenues, it was felt that this was an opportune time to begin breaking down the laws, ordinances, constitutions or charters, in order that such accumulations can be made. There was some question on the use of surpluses for the reduction of debt since new bond issues require a referendum. It was felt that postwar planning is an important job of every community and is the responsibility of the planning commissions of each community, where such commissions exist.

SEATTLE ROUND TABLE

Held at University of Washington, October 16, 1942

Chairman: BENJAMIN H. KIZER, *Regional Chairman, National Resources Planning Board*

Reporter: PROFESSOR VERNON A. MUND, *University of Washington*

There were twenty-one participants in the Seattle round table. It was the consensus of the attending members:

First, that state tax rates should be maintained at current levels as a matter of sound public and fiscal

policy. The accumulation of surpluses, if they should develop, it was felt, is also consistent with a program of creating reserves for postwar public works and the prevention of inflation, although the latter task is primarily the function of the federal government.

Second, that local governments should maintain their tax rates, even though surpluses arise. It was believed that the accumulation of surpluses probably will be accidental, for millage is levied only for current needs.

Third, that the accumulation of surpluses by state and local governments involves dangers of diversion and of ill-advised expenditure.

Fourth, that surplus funds of state and local governments should be used: (a) for reducing debts or for providing for the reduction of debts by means of a sinking fund, and (b) for creating special funds for a specific later use. It was felt that legislative action should provide for the setting aside of these specific reserves. Local officers could be bound by state law to observe such allocations; and, state legislators undoubtedly would feel duty-bound to respect past action.

Fifth, that the campaign for governmental economy is more applicable to the federal government than it is to the state governments. Essential state and local government functions should be maintained, but certain government functions, as public works, should be curtailed to the very minimum.

Sixth, that the question of removing and eliminating intergovernmental exemptions should be explored with a view to minimizing them as far as possible.

That the Tax Commission of the state of Washington be invited to furnish a survey statement on the extent of intergovernmental exemptions in the state of Washington.

Seventh, that the question of the integration of federal, state, and local taxation should be explored and carried into effect as soon as possible.

Eighth, that the principle be adopted that payments in lieu of taxes be made by the government agencies to the same extent that payments are made by like private properties.

Ninth, that the income of future issues of state and local securities be subject to state and federal taxation.

DETROIT ROUND TABLE

Held at Detroit Leland Hotel, October 23, 1942

Chairman: Lent D. Upson, *Director, Detroit Bureau of Governmental Research*

Reporter: Robert S. Ford, *Director, Bureau of Government, University of Michigan*

Forty-four participants took part in the round table. The conference opened with a statement by Miss Walker regarding the purpose of the eight regional round tables that are being sponsored by the Tax Institute. Following its policy of basing the program of the national conference on some particular subject, the Advisory Council this year selected the problems of state and local finance arising out of the war. It was felt that the holding of preliminary regional conferences devoted to the immediate problems in several areas would provide a good background for the national conference.

Effect of the War upon Sales Tax Revenue

Developments in connection with the retail sales tax were summarized by Mr. James Mogan, Deputy Com-

missioner in the State Department of Revenue. In the last fiscal year ending on June 30, the Michigan retail sales tax produced about $81,000,000. Despite the fact that a number of retailers have been forced out of business, the yield of this tax has declined only a half-million dollars in the first three months of the present fiscal year, as compared with a similar period for last year. In the six months from February to August of this year, there was a drop of 3,700 retail licensees out of a total of more than 80,000. Of these 3,700, approximately 2,000 were in the automotive group. On the other hand, certain group of licensees showed an increase, such as food, summer resorts, and roadside stands. Every county in the state had a gain in sales tax collections, except Jackson, Kent, and Dickinson. A significant change has occurred in the source of sales tax collections, with the relative importance of the tax on food sales having risen from 25 per cent of total sales tax revenue to 39 per cent of the total. The explanation for this may lie in the increased cost of food and also in the increased buying of food. Although sales tax collections have not as yet been seriously affected by the war, it is obvious that the real problem will arise after the new federal tax program becomes fully effective and when existing stocks are depleted with no replacements for many items being available.

Other Revenues

The impact of the war on other revenues will not become serious until sometime later. Although gasoline tax collections have declined somewhat, the full effects of the reduction in automobile traffic are not yet apparent because the gasoline tax is collected from the wholesale

distributors in advance of use by the consumer. Gasoline rationing will be extended to Michigan in November, but there is a possibility that gasoline tax collections here may not decline as much as in some states not having so many war plants. The decline in gasoline and automobile registration taxes in the next calendar year will not affect general activities of the state, because the proceeds of these taxes can be used only for highway construction and maintenance by constitutional provision. Profits from operation of the state liquor stores amount to about $12,000,000 annually. The liquor sales will probably be smaller, but this is likely to be offset by increased prices.

The yield of the local property tax—there is no state levy on property—has not yet been affected, but it is anticipated that property tax delinquency will again become a serious problem. As yet, however, the property tax has not been affected adversely, as represented by the rise in assessed valuations this year from $6,200,000,000 to $6,600,000,000, according to Mr. Frank Landers of the State Tax Commission.

Should State Taxes be Reduced?

Although the state government had a surplus of about $7,000,000, on last June 30, it seemed to be the consensus that state taxes should not be reduced in view of the imminence of sharply declining revenues.

The new federal tax program will undoubtedly result in a reduction in state revenues and in state grants to local units. State aid now constitutes approximately one-half of the state budget. With the decline in sales, gasoline, and automobile registration taxes, local revenues will be seriously affected. There are many local

units in Michigan that receive more revenue in the form of state aid than they do from the property tax.

The plan now followed in several other states of investing surplus funds in federal bonds was regarded favorably. It was suggested, however, by State Auditor General Vernon J. Brown that any plan of setting aside or investing surplus funds should also include a provision that such surplus could be spent only on specific appropriation by the legislature.

Local units of government have not experienced any surplus of revenues. With local government debt in the state amounting to about $600,000,000 most localities have had difficulty in meeting debt service requirements. Furthermore, operation of the 15 mill over-all tax rate limitation has created difficult financial problems for many communities since 1933. But even if there were no debt problem, some doubt was expressed as to whether local units could or should be allowed to maintain or invest a surplus created by a tax levy on property. The situation might be different, however, if the funds were used to retire long-term bonds.

Expenditures

The outlook for expenditures of the state government was summarized by Mr. C. S. McNeill, the Acting State Budget Director, who pointed out that increases as well as decreases are in sight. On the list for increasing expenditures were those for state payroll, public welfare, and defense activities; decreases are planned for construction and nonessential activities. He pointed out that general administrative agencies will have added duties because of the war program. State aid for schools is a

large item in the state budget, and the schools will have additional responsibilities, such as the handling of the vocational training programs instituted by the federal government. In addition, teachers' salaries are beginning to increase as a result of the growing shortage of teachers. On the other hand, school enrollment has already shown some reduction, and more may be expected with the drafting of the 18- and 19-year-old boys. The Public Health Department will need additional appropriations to take care of new duties, such as mental hygiene, which is expected to become a major problem.

Highways will show a reduction because they are financed from the proceeds of the gasoline and automobile weight taxes, although the federal government may make additional grants. In the case of regulatory services, such as the Banking Department, some decrease in expenditures may be expected. Certain conservation and recreation activities, financed from the game and fish protection fund, will probably be reduced. Expenditures for public safety and civilian defense are increasing. In connection with economies, Dr. Edward Litchfield of the State Civil Service Department stated that as a result of surveys conducted by that department, the Civil Service Commission was able to suggest reductions of close to $1,000,000 per year involving an elimination of 2,000 positions. In terms of an average working week, that is the equivalent of 4,500,000 man-hours per year. It was his opinion that other surveys conducted in state and local units would show that an equal saving of man-hours could be achieved, which could be diverted to the war effort where there is a labor shortage.

In Detroit and other cities a decrease in welfare expenditures has been offset by an increase in expenditures

for civilian defense. Thus far the fiscal problem in Detroit has not caused too much concern, according to Mr. David Addy, Budget Director of Detroit, because revenues are slightly ahead of what they were a year ago.

Municipalities and the War

It was brought out in the discussion that in a number of cities and rural communities in Michigan, where large war plants are located, a serious problem has arisen in attempting to meet increased demands for governmental services due to the great influx of war workers. If adequate provision is to be made for housing, sanitation, health, schools, recreation, protection, etc., greater assistance will be necessary from the state and federal governments.

This problem is particularly acute in a few townships in the Detroit metropolitan area. The cities are either unable or unwilling to extend their services to the settlements that spring up near the factories, and the township governments cannot provide the facilities necessary for urban living. There are a number of these areas at present where housing and sanitation conditions are extremely serious. The township government is unable to cope with the problem, and the federal and state governments have been slow to step in and assume responsibility. No doubt federal reluctance has been caused to some extent by strong local opposition to federal intervention. The problem will become even more acute in Michigan with the establishment of gasoline rationing, for many workers will find it impossible to continue commuting if they are placed on the "A" card basis. In this connection, Dr. John A. Perkins of the University of

Michigan, stated that out of 1,900 workers who left the Willow Run Plant between September 1 and September 24, nine hundred listed lack of housing as their reason for quitting.

There appears to be no question that federal funds for adequate housing and rapid extension of community facilities must be forthcoming if war plants are to be used to the maximum. When large war plants are established in an area, it can hardly be expected that the local units of government alone would be able to bear the brunt of the increased costs, and especially when it is quite likely that many of these plants will not continue in operation after the war. The problem is aggravated further by the exemption of federal property from taxation. One suggestion offered in this connection was that federal property be subject to taxation in the same manner as privately owned real estate. Another was that with most war workers owning no property in the community adjacent to the plant, the only way they could be reached would be through a local payroll tax. The suggestion which received most consideration was that the payments made by the federal government in lieu of local taxation should cover the full costs of the services rendered, such as for fire and police protection, sewage, etc. In addition, federal grants will undoubtedly be necessary for schools, housing, etc. This is a national problem and it should be recognized as such.

Another aspect of this question is the change that is taking place as a result of the conversion of plants to war production. If a company is working on a lump-sum contract, the machinery and inventory are taxable; but on a cost-plus contract, title to the material passes to the federal government and it cannot be taxed as personal

property. An additional problem arises, as in Detroit, when a large plant is owned by a foreign government and is entirely exempt from taxation under international law. These various exemptions cause considerable financial difficulty to local units.

Although many problems were considered in the conference, the one which seemed to summarize all of them was that of the administrative and tax relationships of the federal, state, and local governments. The chief problem facing many municipalities arises out of the fact that they have suddenly been faced with the problem of making a large expansion in essential governmental services, without sufficient revenue for the purpose and also with the outlook for a precipitate drop in present revenues. In some instances the establishment of certain plants has virtually created a new urban community in a rural township that is utterly incapable of dealing with the situation. Conditions have changed so rapidly since the war that it was practically impossible to anticipate all problems and to plan for them.

Even though the state and local units, except for certain communities with large war plants, have not yet felt the full impact of the war, they will shortly be faced with the problem of how to obtain sufficient revenue to provide essential governmental services. In the long run, the federal tax program necessary for the war will have far-reaching effects on state and local government. Greater planning and consideration of intergovernmental problems are necessary.

It is significant that the coordination of federal, state, and local tax relations is now being studied by four different groups—the United States Treasury Department, the National Tax Association, the American Mu-

nicipal Association, and the Taxation Committee of the American Bar Association. Out of these studies should come an answer, or at least considerable clarification of the question of intergovernmental relationships.

DENVER ROUND TABLE[1]

Held at Government Center, University of Denver, October 28, 1942

Chairman: Carl Feiss, *Planning Director, Denver*

Reporter: Morrison Shafroth, *Grant, Shafroth and Toll,* assisted by Sloan Foundation Students of the Government Center, University of Denver

The all-day round table was attended by thirty-eight participants, several coming from some distance. Each section of the agenda was introduced by an invited speaker who led the discussion for ten or fifteen minutes. The meeting was a lively one with much discussion from the floor and the minutes include a brief summary of both the prepared speeches and the discussion. The conferees were apparently well satisfied with the meeting. The following brief summary does not necessarily reflect the views of all the participants and unfortunately, because space is limited, cannot include all of the interesting opinions and ideas which were expressed.

The invited speakers were Charles Sinclair, County Treasurer, Arapahoe County; Gunnar Mykland, Regional Director, Federal Public Housing Authority, Kansas City; Farrington Carpenter, Director, State Department of Revenue; Charles Wilson, Budget Director of Denver; Frank Wilson, Manager of Revenue, Denver;

[1] Sponsored jointly by Tax Institute, Denver Planning Commission, and University of Denver.

Dave Robinson, Director, Public Administration Service, Chicago; Earl Mosley, City Manager, Colorado Springs, Colorado; Earl Douglas, Commissioner of Revenue, Fort Collins; and Dr. Roy Brown, Acting Director, Department of Government Management, Denver University.

General Conclusions and Recommendations

There were six general conclusions which can be drawn from the discussion. These conclusions were not expressed by formal motion but appeared to be the general trend of thought and agreement.

1. At present there should be as little reduction of local taxes as is possible.
2. Wherever feasible and legal, surpluses should be built up. These surpluses could be used where desirable: first, in the retiring of bonded debt; second, as a reserve for emergencies and for planning purposes.
3. Postwar public works planning is desirable at this time.
4. The federal government should provide adequate compensation in lieu of taxes or services when properties acquired by the federal government, for any purpose whatsoever, are taken off the local tax roll.
5. State governments should accumulate surpluses whenever possible and an equalization plan should be worked out in order that assistance may be given to those communities in which there has been a serious income loss due to population change or other factors adversely affecting the economy of a community during the war.
6. This is the time for a close scrutiny of activities of local, county, and state governments; that since it will be necessary to cut staffs to the minimum an appraisal of organization and management on the basis of efficiency of operation is in order.

Effect of War on Intergovernmental Exemptions

In-Lieu Payments

This section opened with the discussion of the methods used by federal housing agencies in compensating com-

munities for losses in revenue due to the removal of housing land from the tax roll. It was agreed that payments now received in lieu of taxes were hardly more than token payments, although provision has now been made for the payment of full taxes which would be assessed against private building. Appraisal is made by a federal tax analyst. The valuation is usually conservative and the local mill levy is applied to the previously determined base.

Military zones and camps located in rural areas of counties appear to have reduced the amount of taxable property, often creating serious situations. A particularly difficult problem is involved in the influx of workers living in trailers and shacks who pay little or no taxes but require municipal services. The school problem becomes especially serious. Military authorities make demands on county authorities for continuous maintenance of roads in all weather. Few rural counties have sufficient revenue to provide such services. Direct aid through federal grants is necessary in many cases to assist in highways, schools, health, and sanitation problems.

Tax Exemption Policy and State and Local Revenues

There is an imperative need for clarification on tax exemptions for war contracts, particularly in the building industry. There are some 25,000 tax collectors in Colorado collecting sales, service, and use taxes. There is not only a need of clarification of tax exemption laws but there is also badly needed an educational program for collectors and in the schools.

The reduction and elimination of tax exemptions would increase the revenue of governmental units. This is clearly demonstrated by the lower personal exemptions in the income tax. The number of returns in the state of Colorado has doubled and at the federal level has tripled. In general, exemptions create favored groups and it is hoped that many of these can be eliminated.

Changes in the Tax Base

A forsecast was made as to the probable changes in revenue from taxation in the city and county of Denver.

Losses (probable)

Ad valorem tax
- Exemptions
- Restrictions
  - Curtailed building programs; non-use of vacant lots—resulting in forfeiture for taxes; reduced merchandise stocks; frozen stocks as well as entire businesses; rent control program (where it affects real estate values); automobiles and tires
- Licenses and fees
  - Building contractors, electricians, filling stations, garages, motion picture operators, elevators, excavation, sidewalk permits, sign erection
- Parking Meters

No Anticipated Change

- Occupational tax on cigarets

Gains

- Ad valorem tax
  - Recreation centers, warehouses, wholesalers, hotels, rooming houses, etc. (modified by rent control)
- Income tax

It was admitted that it is difficult safely to assert whether or not losses will exceed gains. Certain com-

munities are losing income and others are gaining, due to the war effort. Certain marked losses can, of course, be identified, such as taxes on automobiles and revenues from licenses, not only automobile but also building fees. These may be offset in boom towns by other licenses and fees. It was felt that, in particular, communities which were losing revenues should be compensated from state funds in order that normal services could be maintained, and in order that undue burdens would not be levied on the taxpayer of one community but rather would be distributed throughout a state.

Recommendations

Out of this discussion came the following recommendations as to possibilities for change in sources:

1. Revise present scheme from so much dependency on ad valorem taxes to one taking advantage of business activities through licenses and gross income fees.
2. Attempt increase of in-lieu payments to make them comparable to loss in ad valorem taxes.
3. State tax sales for accumulation of funds to distribute to various local governments carrying unequal burdens.
4. No encouragement and, if possible, elimination of exemptions.

Problems Involved in Wartime Extension of Governmental Services

Discussion Led by Earl Mosley, Colorado Springs

Cities affected by the war were grouped into four classes:

1. Cities that have had military camps established in or near them
2. Cities that have experienced a war industry boom
3. Cities with both army camps and war industries
4. Cities which have had neither war plants nor military establishments and are suffering losses in population and income

Colorado Springs was used as an illustration of the various points brought up in the discussion. A 14 per cent increase in civilian population necessitated increases in the police force and budget despite numerous military police provided by the camps. Health department and sewage disposal plant facilities are taxed. School population has increased to capacity in the lower grades. The city has found it necessary and desirable to undertake and finance a recreation program for service men. New gas, water, and electricity services to military establishments have been satisfactorily handled with the army paying in full for services rendered. Serious shortages in taxes are added to a difficult transportation system. Housing is not yet inadequate. Problems of juvenile delinquency are serious.

A list of ten proposals as to how municipalities might keep budgets down at this period was given, although it was made clear that all of the items on the list were not necessarily recommended:

1. Elimination of WPA projects, putting the money aside for future replacement of equipment
2. The refinancing of city bonds at lower rates of interest and the retirement of these bonds
3. Modification or elimination of police car cruising
4. Discontinuance of patrol of residential districts during the day
5. Use of auxiliary police
6. Garbage collection once a week instead of twice
7. A cautious reduction of expenditures on street maintenance
8. Elimination of city advertising
9. Elimination of municipal amusements, such as band concerts
10. Maintenance of the mill levy at the 1942 level

It was agreed that the most difficult problems which communities are facing are losses of personnel due to the draft, and the competition with federal wage scales. It was concluded that although winning the war is the main

objective it should be clear that local governments must continue to fight crime and poverty.

Appropriate Wartime Fiscal Policy for State and Local Governments

Should Taxes be Revised and Adjusted on State and Local Levels?

It was felt that local government revenues on the whole would remain fairly constant this coming year based on the fact that real estate tax levies and the property tax base will not shrink materially. While increased local expenditures are not anticipated since public works and welfare activities will be curtailed, salaries are being increased about 10 per cent in a number of communities and the question arises as to whether or not surpluses, if they appear, should be built up or taxes reduced to meet expenditures. Only two points of view were expressed on the advisability of building up surpluses: first, that local communities will have unexpected war problems to face; and second, local officials may mishandle surpluses. It was suggested that surpluses be built on the state-wide basis since postwar problems will not necessarily be local in scope only. The meeting held no uniform opinion on the future use of local revenues, but seemed to be unanimous in the opinion that it would be better to accumulate surpluses than reduce taxes. Several interesting points were made in this connection. It was felt that reduction at this time would make it difficult to raise taxes later when resumption of public works activities would be logical, and it was felt that postwar planning, calling for the setting aside of funds now, would be advisable. Another means of disposing of

surpluses might be in the retirement of bonds, although there was some disagreement as to the advisability of this. It was agreed that there was no standard means of handling the situation and that no two communities would face the same problem.

Decrease in Governmental Costs

It was made clear that the principal means of reducing local government costs lies in the postponement of public works and capital outlays until after the war. Priorities on materials and men make such postponement inevitable. It was emphasized, however, that this did not mean that because the projects were postponed, they should not be planned.

There was a great deal of concern over the difficulty of meeting the increased salary demands of municipal employees due to the rise in the cost of living and federal competition, and at the same time preventing, as far as possible, inflationary trends which would result from increasing salaries. An interesting plan was suggested recommending the preservation of basic pay-scales with a monthly bonus check added which is gauged to a reliable cost-of-living index. By this method the usual lag of governmental salaries would be brought up to those of private industry. It was also agreed that the freezing of salaries in the charter was bad practice.

Vacancies being created by men leaving local governmental jobs for the armed forces or war industries tend to counteract increases in salaries, and it was thought that the net result would be a reduction in government cost for personal services. It was agreed that most communities were already working with skeleton staffs and that any further reduction in staff would mean a danger-

ous reduction in services. It was stated that there are too many "sacred cows" in municipal services and that a careful study might provide sensible reductions in every department.

Disposition of Surpluses

The meeting agreed that public works planning at this time was logical and necessary; that local governments should be ready with carefully planned projects in order that it will not be necessary for them to turn to the federal government for aid, and in order that local autonomy be maintained. Any trend to the contrary would be dangerous to our traditional system of government. Plans made now, however, should not be earmarked since flexibility in future programming is essential. Plans should be made in terms of units of materials and man-hours rather than costs, since the value of money in the postwar period cannot be accurately predicted. Existing surpluses at that time can be directly applied as far as they will go and form the basis for borrowing power. Since there will be a shortage of skilled labor and highly finished materials, jobs requiring mainly unskilled workers should be scheduled first.

Where state laws or local laws and ordinances prevent the accumulation of surpluses or the earmarking of revenues, it was felt that this was an opportune time to begin breaking down the laws, ordinances, constitutions, or charters, in order that such accumulations can be made. There was some question on the use of surpluses for the reduction of debt since new bond issues require a referendum. It was felt that postwar planning is an important job of every community and is the responsi-

bility of the planning commissions of each community, where such commissions exist.

BOSTON ROUND TABLE

Held at State House, November 6, 1942

Chairman: HENRY F. LONG, *Commissioner of Corporations and Taxation, Massachusetts*

Reporter: PROFESSOR LUCY W. KILLOUGH, *Wellesley College*

THE TAX Institute round table for the New England area met in Boston on Friday, November 6, 1942. Representatives from Maine, New Hampshire, Massachusetts, Rhode Island, Connecticut, and New York took part in the discussions. There were about seventy people present representing a cross section of the region. Massachusetts was especially well represented by members of the state tax administration, of the state legislature, and by leaders in the financial affairs of many of the cities and towns. Other members of the conference came from colleges and universities, real estate groups, taxpayers' associations, and other organizations. Mr. Henry F. Long, Commissioner of Corporations and Taxation of Massachusetts, who acted as chairman, contributed to the success of the conference both by his own cogent comments and by keeping the discussion within the main channels of important topics.

EXEMPTION OF FEDERALLY SUBSIDIZED HOUSING

The morning session was concerned with various aspects of intergovernmental tax exemptions. The exemption of federally subsidized housing projects from prop-

erty taxes was discussed in considerable detail. Most of the speakers had had experience with such projects in cities and towns of New Hampshire and Massachusetts. Although there were minor differences of opinion, there was practically unanimous dissatisfaction with the existing situation.

The desirability of distinguishing between defense housing and other subsidized housing constituted an important part of the discussion. It was pointed out that the necessity for subsidized housing for persons of very low incomes has come to be widely accepted. Current arguments over such projects are more concerned with the question of who should support them than with whether they should be supported. In the case of defense housing, on the other hand, it was felt that the tenants are financially able to pay adequate rents and that state and local governments should not be expected to contribute to the support of such projects.

Experiences of the cities of Boston and Cambridge, Massachusetts, and Portsmouth, New Hampshire, were cited in respect to the problems of defense housing. In two types of cases some Boston authorities feel that the city is unduly burdened. In one instance, war incomes have so increased the amount of rent collected from housing units that they are now yielding a surplus where they formerly just broke even. At present the federal government is taking five-sixths of this surplus and leaving one-sixth for the state. It was suggested that a half-and-half division would be more in accord with the relative contributions to the project by federal and state governments. In another instance the city of Boston understood that federally owned housing projects which

housed defense workers were to pay the equivalent of the loss in taxes to the city. Actual payments, however, have amounted to only about one-third of the amount which the city expected. Cambridge authorities also feel that federal payments in lieu of taxes on defense housing units are insufficient.

The situation in respect to defense housing in Portsmouth, New Hampshire, is still pending. Projects valued at $1,000,000 to $3,000,000 have been erected in Portsmouth by the federal government. State authorities are hoping that the federal government will agree to pay the amount which would have been assessed on the property if it were taxable.

A final point in respect to defense housing was raised but not answered. This concerned the burdens of postwar readjustments. If Portsmouth, for example, finds itself with more housing than it needs when the war is over, who will bear the charges resulting from overexpanded municipal facilities?

Some of the discussion of tax-exempt housing for low-income families did not pertain directly to the primary subject of the round table—the effect of the war on state and local fiscal affairs. It showed clearly, however, that wartime tax exemption problems will not be solved by the coming of peace. States and localities were dissatisfied before the war with the size of payments in lieu of taxes on federal housing projects. The real estate taxpayer has felt himself unduly burdened by the method of subsidy through tax exemption. The effect of additional exemptions of city real estate on city land values and on the relations between urban and suburban land values is causing alarm in many quarters.

Exemption of Other Federal Properties

The discussion then turned to federal property other than housing. The complete exemption from local taxes of property which is both owned and operated by the federal government seemed to be generally accepted and taken for granted. It was mentioned with approval that the federal government had contributed to school costs in towns adjoining certain army camps, but it was not suggested that these contributions bore any relation to the values of exempted property. The attitude was quite different in respect to privately operated industrial property on government land.

The effect of a large industrial plant on a residential community was well illustrated by the situation in Hingham, Massachusetts. The federal government has taken over a shipyard which is being operated by the Bethlehem Steel Company. The shipyard is expected to employ about 20,000 workers. The town has been unable to collect any money from either the federal government or the Bethlehem Steel Company. At the same time the town finances have been adversely affected in at least three ways—great increases in the wear and tear on the highways with resulting greater costs of upkeep and repairs, greater demands on the police force in enforcing traffic and parking regulations, and a loss of employees to the shipyard because of higher wages. A similar situation was cited in Brunswick, Maine. Apparently local authorities believe that the localities should be reimbursed for at least the extra costs caused by such projects.

Considerable uncertainty was expressed in respect to the legal status of these exemptions. If a state cedes sovereignty and jurisdiction over part of its territory to

the federal government, then the state loses all power to tax even private property within the area. Several suggestions were made to the effect that if the states had taken more care when ceding property they need not have given up all of their taxing powers. An example was given of federally owned industrial property in New Hampshire which is taxed with the consent of the federal government.

Exemption of State and Local Bond Interest

The next subject discussed was that of the exemption from federal income taxes of the interest on state and local securities. There was considerable division between academic opinion and the opinion of the officials of state and local governments. The expressed academic opinion was in favor of eliminating the exemptions as a step toward better application of progressive income tax rates. The other group felt that if the exemptions were removed it would increase the power of the federal government over state fiscal affairs and increase the costs of state and local borrowing. A variety of figures were quoted on the possible addition to interest payments which would be required of states and localities if the exemptions were removed. Some persons felt that such increase in rates would discourage borrowing and that that would be undesirable. Others felt that it would be desirable to discourage borrowing. Still others felt that the rate of interest had little effect on the amount of state and local borrowing.

Some general suggestions rounded out the morning's discussion. It was noted that many exemption problems would be less serious if it were not for the burden upon

real estate. The real estate aspect of the difficulties might be lessened if more local functions were taken over by the states, if the localities were to adopt a city income tax such as that of Philadelphia, or by increased use of sales taxes. One speaker felt that intergovernmental exemptions are becoming so increasingly complex that the best solution would be the complete elimination of such exemptions by some sort of mutual agreement.

Wartime Extension of Governmental Services

The afternoon session touched upon three major topics which had been suggested for discussion by the Tax Institute. These topics were: problems involved in wartime extension of governmental services, changes in local revenue brought about by war, and wartime fiscal policy for state and local governments.

The meeting opened with an official statement in respect to the wartime extension of governmental services in Massachusetts. In general there have not been large war-created expenditures in New England. Priorities have prevented the purchase of new materials and, thus, stopped new public building, public works, and even the renewing of equipment for fire departments. In some instances there have been increases in expenditure on purification or protection of water supply systems. Governments may have to step in to relieve the transportation situation in some localities. So far, most communities have been able to meet the few new war expenditures by transfers from reserves.

The subject of "reserves" as used in Massachusetts finance cropped up repeatedly during the afternoon. Representatives of the interests of real estate taxpayers were very much opposed to the existence of these re-

serves. Others felt that it was desirable for local governments to have funds on which they could draw in case of need.

Some cases were cited where the building of new war plants or bases were creating problems which local governments could not solve. Special mention was made of a new war plant in East Longmeadow, Massachusetts, and of the region near the Quonset Point base in Rhode Island. It was noted that large communities are able to absorb the shocks created by extensive new developments but that small and medium-sized communities may be swamped by them. This type of situation appears to be less serious in New England than in some other parts of the country.

Methods of getting federal aid in welfare problems arising from the war were discussed. New Bedford, Massachusetts, for example, seemed to have reached an impasse in that it could obtain aid for the day care of the children of working mothers only by producing a deficit which state law prohibits. Maine experience seemed to indicate, however, that an anticipated rather than an actual deficit might serve to bring forth the desired federal dollars. There was no discussion of the basic question—should the mothers, the cities, the states, or the nation pay for the care of the children?

Effect of War on Local Revenues

The war seems to have brought to New England few changes in local revenues. Additions to local revenues by federal aids have not involved fundamental changes in local revenue systems. The round table discussed such aids in connection with the exemptions they replaced, or the services they paid for, rather than in

connection with local revenue systems. The recent installation of parking meters in Haverhill, Massachusetts, was the only new type of revenue cited.

Wartime Fiscal Policies for State and Local Governments

The discussion of appropriate wartime fiscal policies for state and local governments brought out marked differences of opinion. The only major point on which there seemed to be agreement was that local expenditures would probably be reduced during the war. This reduction is expected because of the almost complete cessation of capital expenditures. It seemed to be generally assumed that in this area increased costs for normal current services and for war-caused services would not be large enough to take up the slack caused by the lack of new building and replacements.

Several possible policies in respect to this war "surplus" were advocated. It was suggested that no tax reductions should be made, that token reductions should be made, that the largest possible reductions should be made. The advocates of no tax reductions felt that debts should be repaid and surpluses built up for meeting postwar needs especially in replacing worn-out equipment and continuing postponed public building projects. The advocates of token reductions had somewhat the same points in mind but wanted to give the taxpayers the present advantage of slightly lower taxes. The third group felt that not a penny should be raised by taxes above what is needed for absolutely necessary current expenses. They believed that the best repository for

any backlog for future needs is the pockets of the taxpayers themselves.

The ensuing arguments brought to light but did not settle fundamental differences of conviction. At one extreme were those who believed that public officials are not to be trusted with surpluses of any sort even surplus borrowing capacity. It follows from this belief that no taxes should be collected which are not needed for known immediate purposes. Everything above such expenditures should be left with the taxpayers who will be available for further contributions when evidence of what is needed is available. At the other extreme were those who believed that funds held in public treasuries will be available for future public needs and are less likely to be dissipated from public than from private hands.

At the close of the unresolved debate on surpluses and future planning the concluding minutes of the round table were devoted to miscellaneous matters. Concern was expressed over the possibility that the new increased federal income taxes will take so much of the taxpayers' money that they will be unable to meet local levies. Representatives from Boston, New Bedford, and Worcester noted that the financial situations of those cities were less rosy than discussions of surpluses might seem to indicate. A question was raised in regard to the effect of federal orders on local zoning laws.

MEMORANDUM ON FLORIDA'S ECONOMY IN WAR TIME[1]

DEWEY HOOTEN
Florida State Planning Board

BECAUSE OF the fact that a large part of Florida's economy in peacetime is built around the tourist trade, it has probably been more directly affected by the war than any other state. In addition, other important factors in the progress of the state during the past decade must be taken into consideration if the present fiscal status is to be clearly understood. The state is indeed fortunate in that the 1941 legislature, largely through the efforts of Governor Holland, took steps to readjust the economic structure in its session many months before Pearl Harbor.

CHANGE IN BASIS OF REAL ESTATE ASSESSMENT

The one factor most vitally affecting the progress and financial structure of the state was the land boom in the 1920's, and its ultimate collapse. During the boom period practically every political subdivision of the state bonded itself for improvements which would normally take one hundred to two hundred years to acquire, and at the collapse of the boom they were so heavily over-bonded that default was inevitable in many cases. In the ten-year period following the boom, tax delinquencies in-

[1] It was originally planned to hold a regional round table in Florida and C. P. Helfenstein and Dewey Hooten, both Florida State Planning Board, and Walter P. Fuller, Editor, *Fuller's Florida Letter*, were appointed by the Tax Institute as an organizing committee. Because of transportation difficulties and the scattered locations of the Florida cities, it did not seem feasible to try to organize such a meeting. Mr. Hooten kindly agreed to prepare a memorandum on the Florida tax situation as affected by the war.

creased to such an extent that the legislature, in various sessions, enacted a series of tax-adjustment bills through which more than $40,000,000 in taxes was adjusted for less than $500,000. Owing to the antiquated system of tax assessment on real estate, the majority of tax rolls retained the valuations at boom-time prices and high millage rates which, in many cases, created a tax far beyond the ability of the taxpayer to meet. Little was done to correct the weakness of the tax structure until the 1941 session of the legislature.

Until then, the general practice was to assess property on an average of about 25 per cent of actual value and to assess a very high millage rate. This was done, largely to keep the amounts due the state to a minimum. Under this plan, however, homes with a valuation up to $20,000 were exempt under the Homestead Law which exempted all homes valued at $5,000 or less. During the 1941 session, the legislature abolished the state ad valorem tax entirely and made it mandatory that assessments be placed on a basis of 100 per cent of actual value. It also made the state comptroller responsible for the success of the program by arranging for all tax rolls to be submitted to him for approval as to assessment and millage levied before the county commissioners can legally accept the roll. While the state now receives no revenue from an ad valorem tax, the ultimate result, as far as individual counties are concerned, is sure to be satisfactory.

Debt Situation

While the state of Florida has no direct bonded debt, it is an important contributor and administrator to the

debts of its political subdivisions. The total amounts of these debts by classes of issuing units and methods of payment are as follows:

Class of Debt	*Amount*	*Method of Payment*
General county	$7,885,000	Ad valorem tax
County school (B.P.I.) ..	6,056,000	Ad valorem tax
School district debt	44,218,000	Ad valorem tax
Special district debt	13,071,000	Ad valorem tax
Drainage district tax	18,500,000	Acreage tax
County and district road and bridge debt	113,684,000	Gasoline and ad valorem
City debt	199,403,000	Ad valorem tax

Note: The above are approximately the amounts due in 1940.

Earmarking of Gasoline Tax

The state has withdrawn in participation in revenue from the ad valorem tax. Its largest single source of revenue, the gasoline tax, is, by constitutional amendment, committed largely to two functions—road construction, and the servicing and retirement of county and district road and bridge bonded debt. Had gasoline rationing not occurred, the portion of gasoline tax allocated to debt retirement would have been sufficient to take care of these obligations in most of the counties. It is already seen now that ad valorem levies will be necessary in many counties, and if the war continues into 1946 it may be necessary in all counties unless that portion of the gasoline tax (4 cents) reserved for road construction and maintenance, because of curtailment of construction, is, at least in part, allocated to support of this debt.

The constitutional amendment, referred to above, which was adopted this year, is developing other problems in the counties. Until adoption of this amendment the counties received three cents of the seven cents

gasoline tax for debt retirement to be administered by the State Board of Administration. All surpluses were paid to the counties for construction and maintenance of county road systems. The approximate 40 per cent reduction in revenue from the gas tax has already wiped out most surpluses and it is seen that new sources of revenue for county road maintenance will have to be found.

Effect of War on Tax Collections

Schools in Florida are supported, in large part, from funds received from the sale of auto license tags. Receipts from this source are higher than last year, reflecting an increase in the schedule of charges adopted by the 1941 legislature. It is estimated, however, that the sale of license tags will be off 30 per cent next year.

Racing receipts also are expected to be decreased in spite of a 5 per cent increase in the tax. The tracks at present plan to open for the season, but it is not expected that low-salaried military personnel can run up more than a fraction of the bets usually placed by tourists who cannot hope to get to Miami in the numbers the city has entertained in the past. Race track receipts are divided equally among the 67 counties and, although funds from this source are of minor importance to the larger counties, they provide more than 50 per cent of the operating revenue of a number of the smaller counties.

Beverage tax receipts continue upward but increased demands on aid to special classes, supported in large part by this source of revenue, make it unlikely that the diminishing sources can be helped much by this increase.

While the financial condition of the state has been materially improved since the beginning of 1941, at which

time there was a deficit of $1,500,000 in the general revenue fund as compared with a present surplus of $800,000, it is evident that there are many problems to be faced in the future. Owing to gasoline and tire rationing and curtailment of general travel, Florida can hope to have but a small percentage of the usual number of tourists. The rationing system has already materially affected gasoline tax collections, and they will probably be decreased further. Other revenues are, or will be, greatly decreased and it is evident that the state must find other sources of revenue or be forced to curtail its state-aid functions. The advent of war has created additional expenses necessary to such organizations as the State Defense Council. Every possible aid has been given to the manufacturers in an attempt to get defense contracts beneficial to them and to the war effort. Approximately $640,000,000 in defense contracts has been awarded in the state, a large portion of which is for shipbuilding. Military camps have been constructed in every section of the state and the personnel has been gradually increased until it has reached a point at which Florida is virtually an armed camp. This in itself has created a new problem, particularly for the local units, in organizing recreational facilities for these men.

The Outlook for the Future

Municipalities have special problems. They receive no state financial aid and have been seriously affected by the Homestead Law and other laws reducing property tax income. The defense period prior to curtailment of building ushered into the state a large program of construction which, it is logical to expect, will be resumed

after the war. The construction of each home valued at $5,000, or less, reduces the tax base of the municipality involved. Municipalities are also confronted with the immediate need for expansion of nearly all facilities for the servicing of abnormal gains in population as a result of military establishments. Of increasing importance is the problem of finding new sources of revenue for municipalities.

In spite of the expected curtailment of the tourist business, the large hotels and other tourist attractions are opening. It is believed that the war will usher in a new phase in Florida's economy—a phase that will lead to greater diversification. Numerous products and industries that were hitherto of minor importance to the state's economy are coming into prominence. The manufacture of aircraft, plastics, and small metal parts, and the establishment of large shipbuilding enterprises in the state will, undoubtedly, be factors of vast importance to Florida's postwar economy.

The end of the war will bring new problems to the state and to the nation. It may reasonably be expected that there will be at least a brief period with unemployment problems during which there will be a great shifting of population. Therefore, Florida will cooperate to the fullest extent in the war program, and is looking ahead to a new era in the postwar economy and attempting to lay its plans accordingly.

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